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Is Your Hedge Fund-Financed Technology Customer Able To Pay For The Credit Sale?

Scott E. Blakeley, Esq.

Internet start ups, web-based and technology companies, such as social networking site LinkedIn, are making headlines with record initial public offerings, as well as companies such as Groupon and Facebook that are on the verge of IPO's. The technology companies that are not prepared for the IPO stage, are finding hedge funds (HF) and venture capitalists (VC) pouring billions into these technology companies, many of them at the startup stage. The investment strategy of the HF and VC is to often provide the seed money at the startup stage, perhaps put an additional round or two of financing, and cash out through an IPO or when the technology company is sold. If financing, instead of investment, is provided by the HF or VC, the terms and uncommon in contrast with the traditional lender. The HF and VC expect high returns, which may result in an overleveraged technology company, which, in turn, means greater risk of default on a vendor's invoices.

HFs and VCs don't anticipate profits immediately from their technology investments. However, HFs VCs are restless with their technology company investments that don't meet projections. In today's economic climate where double dip recession has been raised, technology companies that have burned through operating cash reserves, that are facing losses and fierce competition, are dealing with tightened investment requirements from HFs and VCs, that may result in a

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Chapter 11 Bankruptcy Venue Reform

Bradley D. Blakeley, Esq.

It is logical to assume that a bankruptcy proceeding should take place in the jurisdiction where the debtor is largely located. However, current law allows debtors to file in the district in which they are headquartered, in the district in which their principal assets are located, in any district in any state in which they are incorporated, or in any district in which one of their affiliates have filed. Such flexibility lead to what many term as "forum shopping". The law allows debtors to choose jurisdictions who applies certain laws that are often more sympathetic to their needs or management-friendly, although that very same management may have driven the company into financial distress. Allowing such elasticity in the law can create severe burdens on creditors, employees, and customers, who become part of the case, to

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Special points of interest:

- Hedge Funds and Venture Capitalists
- Forum Shopping
- Proof of claim
- Fair Credit Reporting Act
- Claims Based On Credit Reporting
- Contracts In California

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Missing A Bar Date May Not Be The End Of The World

Ronald A. Clifford, Esq.

"IF THE CLAIM IS NOT ACCURATELY LISTED, OR NOT LISTED AT ALL, THE VENDOR MUST FILE A PROOF OF CLAIM TO PRESERVE THE CORRECT CLAIM AMOUNT AGAINST THE DEBTOR'S ESTATE"

It is common knowledge among credit professionals that there are certain deadlines by which creditors must take certain steps in a bankruptcy case. One of the most important deadlines in a bankruptcy case is the date by which creditors must submit proofs of claim to the bankruptcy court. To set the table for this article it helps to provide a brief overview of who must file a proof of claim and the purpose of a proof of claim in a bankruptcy case.

The bankrupt debtor is required to file schedules along with their bankruptcy petition, or as soon thereafter as the bankruptcy court requires, that disclose every pre-petition obligation of the debtor. Secured obligations, unsecured obligations entitled to a priority in payment over other unsecured obligations, and unsecured non-priority obligations are all to be listed by naming the obligee and the amount owed to them by the now bankrupt debtor. If a vendor is listed on these schedules as an unsecured creditor for some dollar amount, and does nothing else, that vendor will have a claim against the debtor's estate in that amount as long as the debtor does not object to the claim for any number of reasons later in the case. The debtor is to use their best efforts in listing these claims, but these schedules many times can be inaccurate for any number of reasons. So, it behoves vendors to review these schedules to ensure their claims are listed accurately. If the claim is not accurately listed, or not listed at all, the vendor must file a proof of claim to preserve the correct claim amount against the debtor's estate.

Proofs of claim are simple, one page forms that are usually filed with the bankruptcy court. The actual proof of claim form and instructions on completing it and where to mail the form are often included in an initial notice sent to creditors by the Office of the United States Trustee in the opening days of the case. Many times, included in those notices, or in a later notice mailed by the debtor, is a date by which any proofs of claim must be filed by. This is the aforementioned bar date. Generally, the failure to file a proof of claim by the bar date prevents the creditor from preserving their claim in an amount different than listed on the debtor's schedules, or, if they are not listed at all, preserving a claim against the estate in any amount.

However, there are fail-safes built into the bankruptcy code, and that have been formed through judicial opinions that may protect vendors that fail to timely file proofs of claim in a bankruptcy case. Speaking specifically of a chapter 11 case, whether a late filed proof of claim is deemed timely filed is within the bankruptcy court's discretion. The vendor may file a motion requesting that the bankruptcy court extend the deadline to file its proof of claim, and the bankruptcy court may in-fact extend the deadline if the vendor provides cause for such a measure. Cause is found by the showing of excusable neglect on the part of the vendor. Excusable neglect is somewhat of a loose standard, and allows the bankruptcy court the leeway to take all the circumstances at issue into account to determine whether excusable neglect is present. Whether a set of circumstances rises to the level of excusable neglect will largely depend on whether the failure to act was due to circumstances under the vendor's control. If the vendor did not receive a bar date notice, or was too ill to comport with the notice, then application of the bar date would be punitive in nature in a circumstance that would not seem to warrant such action. However, if the vendor simply forgot to file the proof of claim because they were simply too busy, then excusable neglect would likely not be reason enough to extend the bar date. Again, this is a loose standard that is very factual in nature. Different factual situations will result in different applications of this loose standard. However, suffice to say that the bankruptcy code and corresponding case law does provide a means for the extending of the bar date in some circumstances.

Many plans of reorganization contain provisions that somewhat aid those that have filed

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Credit Where Credit Is Due: Good Practice In The Sphere Of Credit Reporting

In the current economy, it is inevitable that debtors will look more and more to esoteric and creative ways of fighting their creditors. Credit professionals dealing with individuals or small, closely-held companies have to be especially watchful for countersuits. As the cliché goes, the best form of defense is offense, and what might have been originally considered a straightforward collection action can turn quickly into a countersuit, and then a bet-the-company litigation. For credit departments watching their bottom line, the experience can become a nightmarish, runaway train. Countersuits are independent actions, which don't automatically go away when you discontinue your original lawsuit; thus, when faced with one, you may even lose the ability to pack it in and call it a day because you are throwing good money after bad.

One area of law not often seen in countersuits, but which will surely grow in time, particularly given the increased reliance placed on credit scores, are claims based on credit reporting. This article seeks to give a brief overview of the potential issues that can arise in this context, as well as pointers for the credit professional to avoid countersuits.

Fair Credit Reporting Act Violations

The Fair Credit Reporting Act ("FCRA") is a federal statute regulating the dissemination of information relating to consumer credit. In its own words, it was enacted for the purpose of requiring credit reporting agencies to "adopt reasonable procedures for meeting the needs of commerce for consumer credit, personnel, insurance, and other information in a manner which is fair and equitable to the consumer." Facially, it may not appear overly relevant to credit professionals who deal primarily with business clients. However, whether it is in the context of sole proprietorships, or personal guaranties from shareholders, the tentacles of the FCRA can reach into your everyday business decisions, and knowledge of its provisions is important.

Let's start with the most common and important questions: Can you pull the personal credit report of a sole proprietor who applies for business credit? The answer is: Get his/her consent.

Under the FCRA, a credit report can be pulled for specified "permissible purposes." 15 U.S.C. § 1681b. These permissible purposes include: (1) considering the consumer for employment; (2) considering the underwriting of insurance involving the consumer; (3) an application for consumer credit; and (4) an otherwise legitimate business need in a business transaction initiated by a consumer. While this latter purpose of "legitimate business need" might intuitively seem to encompass a sole proprietor's application for business credit, it has been interpreted narrowly. The "legitimate business need" must relate to the consumer relationship. A credit report, however, can always be obtained where consent has been given. As such, it is the easiest bright-line rule to adhere to. Require their consent to a credit report as a condition of extending credit. If they are reluctant to provide it, that says something in and of itself.

Can you pull the personal credit report of a sole shareholder of a corporation you sell to, and who is providing a personal guaranty of the debt? Once again, the answer is: Get consent. The fact that a shareholder is providing a personal guaranty does not alter the nature of the transaction. You are providing business credit, which does not involve a consumer relationship contemplated by the FCRA (e.g. employment, insurance, household finance). You can perform research on the guarantor in other ways – run a search of the bankruptcy docket (www.pacer.gov) to see if (s)he has ever filed for bankruptcy protection; pull the Dun & Bradstreet report of his/her business; run a Lexis Nexis search to find associated companies, and then try to track what happened to them. If you are seeing an individual with multiple defunct entities associated with his name, be suspicious. However, unless you get consent, do not pull the credit report.

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Johnny White, Esq.

"ONE AREA OF LAW NOT OFTEN SEEN IN COUNTERSUITS, BUT WHICH WILL SURELY GROW IN TIME, PARTICULARLY GIVEN THE INCREASED RELIANCE PLACED ON CREDIT SCORES, ARE CLAIMS BASED ON CREDIT REPORTING"

David Mannion, Esq.

1. Innophos, Inc. v. Rhodia, S.A., 10 N.Y.3d 25, 29 (N.Y. Court of Appeals 2008) (citations and quotations omitted).

2. Kass v. Kass, 91 N.Y.2d 554, 566 (1998) (emphasis added.)

3. CA, Inc. v. Ingres Corp., 2009 Del. Ch. Lexis 204, 98-99 (Del. Ch. 2009).

4. Id. at 36-37 (citation omitted.)

5. Id. at 38.

6. Id. at 39-40 (citations and quotations omitted.)

Why Californian Contracts Aren't Worth The Paper They're Written On

Since people stopped resolving disputes by way of arm-wrestle and started putting their agreements in writing it has been a basic rule of law that "the best evidence of what parties to a written agreement intend is what they say in their writing."[1] It would be downright silly if parties to a contract that says X could turn around in court and argue: "Yes Judge, the contract *says* X, but what it *really means* is Y." However, that silliness has been controlling law in California since 1968.

I. The California Problem

The desire for commercial certainty that prompts people to write down their agreements has a sworn enemy. And California has nourished that enemy in a manner unlike the vast majority of jurisdictions. The enemy is "parol" evidence (often referred to as "extrinsic" evidence) which is any evidence outside a contract that is used to determine the contract's meaning. Parol evidence can include everything from emails, to oral testimony about telephone calls, to evidence about the manner in which the parties performed a contract (which may depart from how the contract *says* they would perform).

Outside the Golden State, courts generally won't consider extrinsic evidence in interpreting a contract unless the language of the contract itself is uncertain or, in legal parlance, "ambiguous." As the New York Court of Appeals has said, "[a]mbiguity is determined by looking within the four corners of the document, *not to outside sources*."[2]

However, "there is a difference between California and New York law in how extrinsic evidence is used to resolve any ambiguities in a contract's written language. New York law, which follows the traditional rule, allows the court to examine extrinsic evidence only when the contract's written terms appear ambiguous. [E]xtrinsic evidence is not admissible to create an ambiguity in a contract whose meaning is otherwise clear. *** Under California law, however, extrinsic evidence may be used to explain the meaning of a contract even if the contract appears unambiguous on its face."[3]

That's because back in 1968, in a pretty spectacular show of commercial ignorance, abstract philosophy, and intellectual arrogance; California departed from the "traditional" rule. The culprit: Justice Roger Traynor – the son of impoverished Irish immigrants to Utah who rose to become the 23rd Chief Justice of California and one of the most respected judges in the history of the United States. The abomination: *Pacific Gas & Electric Co. v. G. W. Thomas Drayage etc. Co.*, 69 Cal. 2d 33 (1968).

Chief among the abstract philosophical nuggets in the opinion, Judge Traynor postulated that when a Judge interprets a contract simply by looking at the language of the contract itself, he "determines the meaning of the [contract] in accordance with the extrinsic evidence of [his] own linguistic education and experience."[4] In other words, the very ability to read and understand words that has been acquired by the Judge over his lifetime is *itself* a type of extrinsic evidence being brought to bear on the contract's meaning!

Basically, the key rationale behind the Judge's opinion was that the meaning of words is *always* ambiguous. According to Judge Traynor, "[t]he meaning of particular words or groups of words varies with the verbal context and surrounding circumstances and purposes in view of the linguistic education and experience of their users and their hearers or readers…A word has no meaning apart from these factors; much less does it have an objective meaning, one true meaning."[5]

From there, as if by logic, Judge Traynor ended up stating that "rational interpretation requires at least a preliminary consideration of all credible evidence offered to prove the intention of the parties. Such evidence includes testimony as to the circumstances surrounding the making of the agreement…so that the court can place itself in the same situation in which the parties found themselves at the time of contracting."[6]

Why Californian Contracts Aren't Worth The Paper They're Written On

In other words, in the space of just 3 pages, Judge Traynor went from saying that Judges cannot accurately ascertain the intentions of the parties simply by reading the words in their contract (since Judges' perceptions are colored by their linguistic education and experience); to saying that Judges are *more* likely to reach correct results if they teleport themselves to a time and place they have never been, and seek to divine the subjective thoughts and intentions of the contracting parties! Sure, words aren't perfect when it comes to communicating. But they're markedly better than telepathy!

Hidden away at the bottom of the eighth footnote in the opinion is the statement that has the potential to destroy the value of any promise governed by Californian law. According to Judge Traynor, contractual "ambiguity may be exposed by extrinsic evidence that reveals more than one possible meaning."[7] In other words, while the language in a contract may be clear, extrinsic evidence may be considered to show that the language does not, "in reality," mean what is says. As subsequent decisions have put it, the extrinsic evidence, in effect, supplies the ambiguity where none otherwise existed.[8]

That rule invites parties to conjure up any and every piece of "evidence" they can in an effort to show they intended something other than what the language in their contract says. As Alex Kozinski, Chief Judge of the Ninth Circuit Court of Appeals, has aptly observed: "Pacific Gas casts a long shadow of uncertainty over all transactions negotiated and executed under the law of California. [E]ven when the transaction is very sizeable, even if it involves only sophisticated parties, even if it was negotiated with the aid of counsel, even if it results in contract language that is devoid of ambiguity, costly and protracted litigation cannot be avoided if one party has a strong enough motive for challenging the contract. While this rule creates much business for lawyers and an occasional windfall to some clients, it leads only to frustration and delay for most litigants…"[9]

One of the biggest problems with California law on this topic is that an accommodation may subsequently be recharacterized as an *agreement*. Take for example a supply contract with a five year duration. One term provides that "payment is due within thirty days of delivery" and another provides that the contract "may be terminated by the vendor for late payment." It seems clear (or "unambiguous") that this contract could be terminated by the vendor if payment had not been made on the 31st day after a given delivery.

Now imagine this contract is performed in the real world rather than the philosophical recesses of the Pacific Gas fields. This customer provides a lot of your business, and the economy is in terrible shape. You routinely accept payments 50 days after delivery. However, time goes by and the amount of their orders decrease. The economy is recovering and your company has changed direction. You decide this customer is not worth the hassle, and you're sick of extending interest free loans to their business. 50 days pass and you haven't been paid for a particularly large shipment, so you mail the termination notice.

In Judge Traynor's courtroom, the customer will be permitted to introduce evidence to show that (despite what the contract says) the parties never intended for termination to be possible just because a payment had not been made 30 days after the date of a given delivery. The proof? You routinely accepted payments 50 days after delivery without terminating!

In New York, a case like this is begging to be resolved without discovery on the basis of the express terms of the contract. However, in California the court may decide to admit evidence showing that "late" did not mean "late." Rather, "late" meant something more than 20 days late. Even if you ultimately win, your choice of Californian law has compromised the two most important goals in a breach of con-

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"ONE OF THE BIGGEST PROBLEMS WITH CALIFORNIA LAW ON THIS TOPIC IS THAT AN ACCOMMODATION MAY SUBSEQUENTLY BE RECHARACTERIZED AS AN *AGREEMENT*"

7. Id. at 40.

8. See e.g. De Anza Enters. v. Johnson, 104 Cal. App. 4th 1307, 1315 (Cal. App. 6th Dist. 2002) ("[T]he courts should treat a document as what it says it is unless extrinsic evidence supplies notice of ambiguities…") (citation omitted).

9. Trident Ctr. v. Connecticut Gen. Life Ins. Co., 847 F.2d 564, 569 (9th Cir. Cal. 1988).

Why Californian Contracts Aren't Worth The Paper They're Written On

tract suit: speed and efficiency.

II. The Solution and a Sample Choice-of-Law and Choice-of-Venue Clause [10]

So what can you do to protect yourself? Simple. Choose to have your contracts governed by the law of a state *other than California*! That does not mean you won't be able to litigate in California; it just means the Californian court where you end up will apply the law of some jurisdiction other than California. By all means, choose a venue provision that provides exclusive jurisdiction to the Superior Court in L.A. County. Just don't choose California law as the governing law.

So can this be done, and which state's law should you choose? In California, the procedure followed for determining the enforceability of a contractual choice-of-law provision requires the court to determine "(1) whether the chosen state has a substantial relationship to the parties or their transaction, or (2) whether there is any other reasonable basis for the parties' choice of law."[11] So what satisfies this test?[12]

Well, "[i]f one of the parties resides in the chosen state, the parties have a reasonable basis for their choice." *Id.* at 467. So if your customer is located in a state other than California, you could consider choosing the law of that state. As far as the admission of extrinsic evidence is concerned, the law of Oregon[13] and Nevada[14] are both far preferable to the law of California. Unfortunately, Pacific Gas has leaked into Arizona.[15]

Another possible way to avoid the application of Californian law is to choose the law of the state where either your company or your customer's company was incorporated.[16] According to the Delaware Department of State, more than 900,000 business entities are incorporated in Delaware (including more than 50% of all U.S. publicly-traded companies and 63% of the Fortune 500.) So Delaware law may be available in transactions involving "Californian" companies.[17]

I can't stress enough that there is no one-size-fits-all solution to the issues facing parties to prospective business transactions.[18] But, for the sake of fun, if I was asked to draft a choice-of-law clause that would be the most beneficial to the most Californian companies in the greatest number of transactions, here's what it might look like:

> The interpretation of this contract shall be governed by the laws of the state of Delaware and all disputes relating to the interpretation of this contract shall be resolved in accordance with Delaware law. To the extent it is judicially determined that the law of Delaware is inapplicable, the laws of the state of Nevada relating to contract interpretation shall apply. To the extent it is judicially determined that the law of Nevada is inapplicable, the laws of the state of Oregon relating to contract interpretation shall apply. However, notwithstanding anything to the contrary herein, if any dispute whatsoever arises out of or in connection with this contract the parties agree to bring suit only in a court located in the County of Los Angeles, State of California, and violation of this term will bar recovery in any other court. Furthermore, the parties expressly submit and consent to the jurisdiction of the federal and state courts located in the County of Los Angeles, State of California.

10. This article is not intended to be a D.I.Y. legal pamphlet. Every factual situation presents unique legal nuances that are way beyond the scope this article (or, indeed, any article that does not address the specific facts of that situation). Legal advice should be sought prior to the execution of every contract, particularly every high value contract.

11. Nedlloyd Lines B.V. v. Superior Court, 3 Cal. 4th 459, 466 (Cal. 1992).

12. It should be noted that choice-of-law issues arising from contracts subject to the UCC are governed by California Commercial Code § 1105(1) which provides that the parties may choose the law of a state having a "reasonable relation" to the transaction. However, as observed in Nedlloyd Lines, "[t]his 'reasonable relation' test appears to be similar to the 'substantial relationship' test."

13. In Oregon, "[t]o interpret a contractual provision…[f]irst, the court examines the text of the disputed provision, in the context of the document as a whole. If the provision is clear, the analysis ends." Yogman v. Parrott, 325 Ore. 358, 361 (Or. 1997). If the contractual provision is ambiguous, only then does the court "examine extrinsic evidence of the contracting parties' intent." Id. at 364.

14. In Nevada, "[w]here a written contract is clear and unambiguous on its face, extraneous evidence cannot be introduced to explain its meaning." Kaldi v. Farmers Ins. Exch., 117 Nev. 273, 281 (Nev. 2001)(citations and internal quotations omitted).

15. See Taylor v. State Farm Mut. Auto. Ins. Co., 175 Ariz. 148, 154 (Ariz. 1993) (modified on other grounds) (citing Pacific Gas & Elec. Co., supra.).

16. See Nedlloyd Lines B.V. v. Superior Court, supra at 467 ("A party's incorporation in a state is a contact sufficient to allow the parties to choose that state's law to govern their contract.")(citations and internal quotations omitted.).

17. Like New York and the majority of other states, Delaware "adheres to an objective theory of contracts, under which [it] does not resort to extrinsic evidence to interpret the intent of the parties, to vary the terms of the contract or to create an ambiguity when the contract terms are unambiguous. [U]nder this objective theory, the Court is constrained by a combination of the parties' words and the plain meaning of those words[.] Delaware courts will not destroy or twist contract language under the guise of construing it." Rossi v. Ricks, 2008 Del. Ch. Lexis 99, 5-6 (Del. Ch. 2008) (citations and quotations omitted.)

18. For transactions bearing some relationship to New York and involving amounts in excess of $250,000.00, additional options may be available by virtue of, among other provisions, N.Y. Gen. Oblig. Law § 5-1401. Those issues are beyond the scope of this article.

Credit Where Credit Is Due: Good Practice In The Sphere Of Credit Reporting

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The consequences for failure to comply with the FCRA can be serious. Criminal penalties are possible. And in the context of a civil action, for willful noncompliance, punitive damages can be assessed against the offender, and a court can order payment of the consumer's attorney fees. The statute of limitations on actions is 5 years, or 2 years after discovery of the violation. Thus, if during the discovery/document production stage of a lawsuit, it emerges that you pulled a credit report without authorization, even if it occurred years ago, your debtor could still bring that countersuit.

Fair Debt Collection Practices Act Violations

Another pillar of federal regulation of the consumer credit industry is the Fair Debt Collection Practices Act ("FDCPA"), which puts limits on the types of actions lenders and collectors can take when pursuing a debt. For example, it prevents a collector contacting neighbors or friends, it limits the time of day when a collector can call up a debtor, and other forms of harassment. As with the FCRA, the FDCPA was enacted to regulate consumer credit, which means that business debts are not covered by it. When dealing with a sole proprietor or guarantor, your debtor will often labor under the mistaken belief that the FDCPA applies to them, but this is incorrect. When violations of the FDCPA are threatened, they are generally hot air. (Of course, that should not be taken as tacit approval of sharp collection practices, which could be independently actionable. Be civil.)

Common Law Slander of Credit Under State Law

While not being regulated by the above federal statutes is fortunate for business credit in one respect; in another, it opens the door to a different avenue of attack for debtors: a common law defamation action for slander of credit. Under the federal doctrine of "preemption," when federal law occupies a field, potentially conflicting state law can be displaced in whole or in part. Certain courts hold that the FCRA partially preempts defamation claims; however, as business credit is not covered by the FCRA, there is nothing to prevent your sole proprietor/guarantor suing for defamation.

The elements of a typical state law claim for defamation are: (1) publication; (2) of a statement of fact; (3) that is false; (4) and made with negligent disregard for the statement's truth or falsity; and (5) made without privilege. Certain statements can attract the characterization of "defamation *per se*," which means no explanation of their defamatory nature is required to be proved One such category of defamation *per se* are statements which tend to injure a person in their business or profession. Needless to say, a false claim that a person fails to honor their business debts would be such a statement. Thus, reporting a sole proprietor/guarantor to collections should be done with caution if there is a suggestion that a customer is disputing the debt's validity. If you are going to be suing them anyway, there is little to be gained.

The possibility of a countersuit for defamation also provides another reason why a demand letter is a good practice before proceeding with more heavy-handed collection methods. A defamatory statement must be published to a third-party to be defamatory. A letter not addressed to any third party does not do this; and if it elicits no response from your debtor, the chance of a dispute cropping up later is less likely. But remember, while caution is always an advisable approach, don't be too scared – truth is always an absolute defense.

"AS BUSINESS CREDIT IS NOT COVERED BY THE FCRA, THERE IS NOTHING TO PREVENT YOUR SOLE PROPRIETOR/ GUARANTOR SUING FOR DEFAMATION"

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failure to pay vendors.

For the vendor selling to the technology company, the capital structure is not like a bricks-and-mortar enterprise that relies on bank financing or internal financing to operate. Banks and asset-based lenders generally do not offer financing to the technology company because of its limited operating history and lack of tangible assets to secure the financing.

However, when a technology company's funding does evaporate, it often desperately searches for a buyer of the business. The insolvent technology company either shuts its door, finds a buyer or takes cash at any price, and vendors commonly go unpaid. Technology companies have even found their creditors suing to halt their cash burn rate in hopes of preserving assets to pay debt.

Assets to Pay Vendor's Invoices?

The value of most technology is intellectual property, such as customer lists, licensed technology and engineering teams. In analyzing whether to sell the technology company on credit, the credit professional must consider different credit criteria then a company whose primary assets may be tangible assets (bricks and mortar). Excess cash burn rate is often the benchmark to determine whether the technology company has assets available to pay for the credit sale. However, given that the foundation of a technology company's value (technology and engineering teams) is constantly evolving, with some technology becoming obsolete or no longer popular, a credit professional providing goods or services to the technology company can not necessarily look to the HF and VC to provide an additional round of financing as a source to pay the vendor's open invoices. Indeed, HFs and VCs may view the current technology investment market as overpriced, as was the case of the dot-coms in the 2000's. This may mean it is harder than ever for certain technology companies to obtain additional affordable financing, or a buyer and, with that, harder to pay the vendor.

No Assets Available For Vendors With Liquidating Technology Company

A number of initially well-funded technology companies have closed their doors, and auditors for some technology companies have issued warnings that the technology company's survival is in "substantial doubt." Technology company liquidations are growing for some sectors, and a technology company's liquidation yields little for vendors. Indeed, a technology company's market value bears little in a value liquidation.

While a bricks-and-mortar company may have tangible assets that will allow it to reorganize should it run into financial difficulty, technology companies do not fare well. The technology company that cannot obtain an additional round of financing simply disappears. While a bricks-and-mortar company may find a buyer for its assets, a technology company usually does not have such an opportunity. A technology company's assets are liquidated at a fraction of their going concern value.

Analyzing Cash-Burn Rate

A technology company usually does not generate profits or have meaningful tangible assets, and traditional credit scoring may not be an accurate measure of risk of non-payment with a credit sale. With a publicly traded technology company, the stock market may be a method for measuring its financial strength and ability to repay a credit sale. Given the HFs and VCs reluctance to provide additional financing to a technology company, the credit professional must analyze the excess cash burn rate more closely than ever. The cash burn rate is determined by the amount by which a technology company's expenses exceed its cash flow. Start-up technology company's often raise a year's worth of cash to operate at a time. The adage "cash is king" seems especially true for a technology company, given their lack of alternatives to finance operations.

"EXCESS CASH BURN RATE IS OFTEN THE BENCHMARK TO DETERMINE WHETHER THE TECHNOLOGY COMPANY HAS ASSETS AVAILABLE TO PAY FOR THE CREDIT SALE"

Is Your Hedge Fund-Financed Technology Customer Able To Pay For The Credit Sale?

To determine how long cash may last, and the prospects for payment on a credit sale, the credit professional may divide the technology company's burn rate by the amount of cash it has. If the technology company is publicly traded, the credit professional may look to the quarterly burn rate. A high burn rate will result in the technology company unable to finance operations and repay vendors.

Obtain Financials for a Burn-Rate Analysis

In addition to funding delays, technology companies may be receiving less HF and VC funding than projected and the funding may be dispersed incrementally based on milestone accomplishments. To that end, the vendor should consider insisting on the technology company provide the status of HF and VC funding, especially if the technology places a large order. The vendor can offer a nondisclosure agreement as an incentive for the technology company to provide the funding milestones. The vendor can also request the technology company request a bank reference as to where the HF or VC funding is maintained. The vendor can also request that the HF or VC furnish a guaranty to back the vendor's credit sales. Should the technology company default, the vendor may call on the HF or VC to pay for past due invoices.

Still Opportunity For Sales

With concern of a double dip recession, HF and VC funding may pull back. Given this, a technology company's cash-burn rate is key with any credit analysis.

Missing A Bar Date May Not Be The End Of The World

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a proof of claim after the bar date. Section 726(a)(3) of the bankruptcy code provides that those creditors that file proofs of claim late may still be entitled to a distribution, but behind those that timely filed proofs of claim. This provision of the bankruptcy code may provide a backstop for those that file late filed proofs of claim. Again, this is not as popular of a provision in plans as one would imagine given that it is a bankruptcy code section, but to the extent it is, or to the extent a vendor can move to ensure it is added to a plan, the vendor may be able to salvage the claim.

The take away for vendors is that, first, always file proofs of claim right away. There is no harm in filing a proof of claim, even if the vendor's claim is correctly listed on the schedules. It may be a belt and suspenders approach, but it will help to ensure that a bar date is never missed. Second, if a bar date is missed, it is important not to give up on the claim. There may be ways to salvage the claim through means such as filing motions requesting that the court extend the deadline, or by requesting that a class be added to a plan for those that have filed proofs of claim late.

"IF A BAR DATE IS MISSED, IT IS IMPORTANT NOT TO GIVE UP ON THE CLAIM"

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Chapter 11 Bankruptcy Venue Reform

(Continued from page 1)

travel hundreds or thousands of miles to participate, even though they did business with the debtor in a completely different location. A prime example is The Los Angeles Dodgers who filed their bankruptcy in the District of Delaware where they have an incorporated entity, but no assets, operations, or even substantial creditors.

Certain members of Congress are now aiming to put an end to forum shopping. On July 14, 2011 House Judiciary Chairman Lamar Smith, a Republican from Texas, and John Conyers, Jr., a Democrat from Michigan, introduced the Chapter 11 Bankruptcy Venue Reform Act of 2011 (H.R.2533). The act would require corporations to file their Chapter 11 Bankruptcy Petitions in the judicial district where they have there principal place of business or assets. This narrow specification in the proposed change will limit the courts in which bankruptcy cases can be heard. The act would retain the exceptions needed to remove a case to another location for good cause or convenience. However, the focus of the law requires that the interest of the entire creditor body be evaluated, and not just the mere preference of the debtor when choosing a forum.

It is no coincidence that the bi-partisan sponsorship comes from congressmen representing states that have produced landmark bankruptcy cases: Enron from Texas and General Motors from Michigan. Upon filing for bankruptcy, both of these companies sought to file petitions in the Southern District of New York, which is more than 500 miles from Detroit and 1,500 from Texas. While the aim is to end forum shopping, the goal of the act is to ultimately level the playing field and restore fairness, said Congressman Conyers.

Opponents to the proposed legislation argue that the courts already have mechanisms in place, via 28 U.S.C. §1412, to transfer venue to another jurisdiction if they determine that the current venue was initially chosen in an improper manner or that the existing forum is inconvenient for the relevant parties. Aside from the argument above, opponents have also pointed to a slew of protections afforded to employees, retirees, and trade vendors, which Congress has enacted through changes to the BAPCPA. In sum, detractors dispute the haste and legitimacy of the legislation.

As a creditor, the advantages to this act appear quite clear. Cumbersome travel to courts located in the far corners of the U.S. may become a thing of the past. Techniques such as bootstrapping, in which debtors-to-be create subsidiaries in bankruptcy friendly venues in order to have the ability to file there, will be eliminated. The benefits would appear to give employees, creditors and the likes not even an upper hand, but a level playing field, which may be deserved, in bankruptcy various proceedings, including preference actions. But there could be adverse consequences, such as overstretching the limited resources in the judiciary and delaying the administration of the proceedings due to court inefficiencies.

On Thursday, September 8, 2011 at 10:00 a.m. a hearing is set for the subcommittee on Courts, Commercial, and Administrative Law of the House Judiciary Committee to meet and discuss H.R. 2533, the "Chapter 11 Bankruptcy Venue Reform Act of 2011."