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BLAKELEY & BLAKELEY QUARTERLY

Volume 3, Issue 1 Winter 2013

Self-help to Setoff A Delinquent Account: A Reminder of Legal Boundaries

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The recent chapter 11 filing of clothing retailer Betsey Johnson (debtor) and the lawsuit filed against one of its vendors reminds the vendor of the legal limits, as well as the legal boundaries, of the self-help strategy of setoff.

Setoff as a Self-help Tool

A credit professional's focus to improve the quality of their A/R portfolio is a key responsibility, appreciating the balance with the organizations focus on market share, yet mitigating credit risk. Understanding the tension between credit and sales, the credit professional considers that where the applicant does not score out or the customer no longer scores out, the professional looks to it's credit and collection policy to reduce credit risk through credit enhancements, such as guarantees or letters of credit, or payment alternatives, such as credit cards. Where the credit professional may not be able to obtain a credit enhancement or payment alternative and the customer breaks their promise to pay on terms, a credit professional may consider a more creative approach to collect the delinquent account. The credit professional may try to reduce a delinquent account through a self-help strategy, such as selling a customer's inventory held by the vendor to specially manufacture the customer's product as a way to offset past due invoices of the vendor.

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Garnishing An Out-of-State Bank Account? Yes, It May Be Possible

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Judgment creditors often face the issue of whether they can levy on the bank account of an out-of-state judgment debtor. In a common scenario, a judgment creditor, often through its a forum-selection clause in its credit application or contract, obtains a judgment in their home state against an out-of-state judgment debtor. Using the judgment debtor's checks, credit application or perhaps a third -party service, the judgment creditor confirms that the judgment debtor uses a bank with branches in the judgment creditor's home state. Now the question for the judgment creditor is can it levy on the bank in its home state?

The answer can take two forms depending on whether the bank is state chartered or federally chartered. Many years ago, when most

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Special points of interest:

- Setoffs
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- "Adequate Protection"
- Unsecured Credit Sales
- Delaware Bankruptcy
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GUEST ARTICLE

Credit Managers You Can Be a Hero: Contribute to Your Company's Revenue and Profit Performance

Trade credit is major source of capital for businesses buying from other businesses in United States. During the recent recession banks have tightened borrowing requirements significantly. This has increased reliance by both the seller and the buyer on trade credit terms for the working capital needed to operate their businesses successfully. A company's ability to extend reasonable credit terms to its' customers and collect what is owed promptly has had an increasing impact on revenue and profit. The Credit Manager is responsible to ensure that the company's credit and collection objectives are met.

Unfortunately, often the Credit Manger's role is misperceived by the Sales team. The Credit Manager may be seen as an obstacle to closing the deals needed to make quarter or year end revenue goals. The Credit Department is looked at as an overhead cost center, there by necessity, imbedded somewhere deep in the Accounting and Finance function.

Credit Managers can change that perception. Be a hero by showing Sales and other stakeholders how you can help them develop "smart" revenue and profit opportunities. A properly run Credit Department is both a profit center and provides credit products your company can offer to beat the competition and maximize sales. Yes, credit policies and on the shelf alternatives can be a products just as valuable to the sales process as your company's products or services.

Making these good things happen boils down to three action areas for a Credit Manager:

Policy: A well thought out and communicated credit and collection policy.

Options: On the shelf alternatives to maximize revenue and manage risk within the risk tolerance of the company.

Tools: Excellent systematic tools to analyze creditworthiness, collect AR, administer cash receipts, manage disputes and deductions and provide transparency with customizable dashboards and management reporting.

The following offers further explanation and some ideas as to how these concepts can be implemented to maximize your company's revenue potential.

Credit and Collections Management is an Art and a Science

Anyone who has managed credit and collections over time knows that this profession is a mix of science and art. The science gives you the facts needed to understand the risks, the art is how you use the tools available to manage that risk and aggressively work to maximize profit opportunities.

There is an interesting quote that applies here: "Someone who owes you a little money is your slave. Someone who owes you a lot of money is your master". (Anonymous) **The** "Art" of credit risk and collections management is to keep everything in balance.

To start you have to answer a few questions about your credit and collections department. Your honest answers will help determine the value your department adds to the sales and profit of your company.

1. Are you helping to maximize your company's working capital opportunities? If yes, is that the perception of other departments? Your boss?

2. Does your department address your company's financial and marketing/sales strategies? Do you consider profit objectives, competitive conditions, product sales goals etc. in your credit decisions?

3. Can you articulate the simple compelling need for your department? Do you communicate the return on the Company's investment (ROI) for your function?

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It's Complicated: Revisiting *BIG3D* and *DEICO's* Inadequate Guidance for Adequate Protection

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The undefined phrase "adequate protection" appears in several key provisions of the bankruptcy code, and the success or failure of an attempted restructuring often hinges on the question of whether "adequate protection" exists. Crudely put, the thrust of the concept is that a debtor may not use a secured creditor's collateral without compensating the secured creditor for any loss of value arising from the use of the collateral during bankruptcy. While this notion is easily stated, how it can and should be applied is a vexed question. One issue on which the respective bankruptcy courts have diverged is when adequate protection payments should begin. That is, assuming a secured creditor can show the value of its collateral is declining, when should it start receiving payments to compensate for this?

Some early case law found that the right to adequate protection payments, regardless of when they were requested, arises on the date bankruptcy is filed, and collateral should be valued from that date in determining what the creditor is owed. In more recent times, most Courts have moved towards the view that no right to payment arises until a creditor formally makes a request to the bankruptcy court, and the collateral's value is measured from the date the creditor files that request. The 9th Circuit, which includes California, – no stranger to bucking trends in law as elsewhere – employs a test unique to the 9th Circuit. First stated by the Bankruptcy Appellate Panel (the "BAP") in *In re Deico Electronics, Inc.,* 139 B.R. 945 (B.A.P. 9th Cir. 1992) (hereinafter "Deico"), and more recently affirmed in *People's Capital & Leasing Corp. v. Big3D, Inc. (In re Big3D, Inc.),* 438 B.R. 214 (B.A.P. 9th Cir. 2010) (hereinafter "Big3D") a secured creditor in the 9th Circuit is entitled to adequate protection payments from the point in time when it "would have exercised its remedies under state law absent a bankruptcy filing." *Big3D* at 222. More specifically, it is from "that point that the value of the [collateral] would have been converted to cash." *Id.* at 223.

In reaffirming the *Deico* test in *Big3D*, the 9th Circuit BAP posed itself the question whether "Deico's standards for determining appropriate adequate protection [are] fundamentally unworkable?" It concluded that it was an "inherently factual determination, but the fact that such a determination can be complicated does not make it unworkable." *Id.* at 230. This article revisits that question, and challenges the BAP's answer. It argues that *Big3D* and *Deico*, which involved comparatively straightforward collateral, were inappropriate gauges of the true practical difficulties that may be encountered by courts applying the test the BAP has articulated.

Deico

Deico is a short decision, and its length reflects the relative simplicity of the facts that were before the Court. The secured creditor in *Deico* was Paccom, an equipment leasing company, which had twice requested adequate protection payments from the bankruptcy court. By the time of the ruling on its second request, the case was over nine months old, and Paccom asked that payments be backdated. The bankruptcy court granted monthly payments of $5,000, finding that Paccom's collateral was depreciating, but denied the request to backdate them to the petition date or even the date of the request. Paccom appealed, and sought clarification under the law of "when it became entitled to adequate protection payments." *Deico* at 946.

In upholding the refusal to backdate payments, the BAP took its cue from the purpose of adequate protection, as explained by the Supreme Court a few years earlier. This purpose is to compensate secured creditors for "the delay that bankruptcy works on the exercise of their state law remedies." *Id.* at 947 *citing United Saving Association v. Timbers of Inwood Forest,* 484 U.S. 365, 108 S. Ct. 626 (1988). It described the appropriate process of analysis for bankruptcy courts faced with a

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"SOME EARLY CASE LAW FOUND THAT THE RIGHT TO ADEQUATE PROTECTION PAYMENTS, REGARDLESS OF WHEN THEY WERE REQUESTED, ARISES ON THE DATE BANKRUPTCY IS FILED"

The Importance of Documenting Unsecured Credit Sales from the Litigation Perspective

David Mannion, Esq.

Selling goods on credit is inherently risky business. In essence, unsecured creditors are handing over their product and saying: "pay me later; I'll take your word for it." Indeed, the word "credit" is derived from the Latin "Credo," meaning "I trust you." Vulnerable as they may be though, unsecured creditors can still take certain simple steps that may go a long way towards mitigating the damage when they've trusted the wrong person. Apart from having a personal guaranty, maintaining proper documents is at the top of that list.

I. Documents that should be maintained by Unsecured Creditors.

The most important documents to maintain for every shipment of goods are invoices and proofs of delivery (for both the goods and the invoices). The proofs of delivery – whether they are bills of lading, FedEx tracking receipts, or something else – should be signed or acknowledged by a representative of the debtor. A bill of lading signed by a third party carrier will not suffice.

In addition, all invoices should be emailed to the debtor and read-receipts and delivery-receipts for those emails should be requested using the "options" function in Microsoft Outlook. Email receipts should be saved, together with the corresponding invoices and proofs of delivery. In fact, insofar as practicable, the vast majority of your communications with a debtor should be conducted through email. When dealing with a large corporate customer, always copy a director or senior manager on important emails.

The importance of properly documenting credit sales cannot be overstated. This is true in in a whole host of litigation scenarios including, for example, the defense of preference actions. However, this article focuses on the prosecution of the garden variety collection lawsuit.

II. Pre-Discovery Summary Judgment: What it is, and why you want it in Every Collection Case.

"Discovery" is the process of obtaining information from the other side in preparation for trial. It can include serving requests for documents, subpoenas, written interrogatories, and depositions.[1] Apart from trial, the discovery process in general, and depositions in particular, is the most expensive aspect of litigation. However, where a creditor has properly documented their transactions there may be a shortcut to a final judgment that sidesteps most or all of the discovery process. That shortcut is called "summary judgment."

In Federal Court, summary judgment is governed by Rule 56 of the Federal Rules of Civil Procedure, and similar procedural mechanisms exist in most states. Basically, summary judgment is granted when the evidence is so clear there's just no point having a trial.

However, regardless of jurisdiction, there is a general attitude that "[s]ummary judgment is a drastic remedy to be used sparingly[.]"[2] Thus, "[t]he party who moves for summary judgment has the difficult burden of showing that there is an absence of a genuine issue as to any material fact."[3]

According to the Supreme Court, "at the summary judgment stage the judge's function is not himself to weigh the evidence and determine the truth of the matter but to determine whether there is a genuine issue for trial."[4] Federal Courts in New York and elsewhere "resolve all ambiguities, and credit all factual inferences that could rationally be drawn, in favor of the party opposing summary judgment,"[5] in this case the debtor.

Unless a creditor has kept its documentary ducks in a row, a debtor will frequently be able to conjure the purported "issue of fact" needed to defeat a summary judgment motion. Upon losing summary judgment, a creditor generally has no choice but to settle from

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1. FOR A MORE DETAILED INTRODUCTION TO THE DISCOVERY PROCESS, CONSULT THE ARTICLE OF JOHNNY WHITE, ESQ. PUBLISHED IN CREDIT TODAY. HTTP://WWW.CREDITTODAY.NET/PUBLIC/COMPELLING_DISCOVERIES_A_PRIMER_IN_PRETRIAL_PROCEDURE_FOR_THE_CREDIT_PROFESSIONAL.CFM

2. TUBACEX, INC. V. M/V CAPETAN GEORGIS II, 1986 U.S. DIST. LEXIS 27127, *1 (S.D.N.Y. 1986) (CITING UNITED STATES V. BOSURGI, 530 F.2D 1105, 1110 (2D CIR. 1976)).

3. ID.

4. ANDERSON V. LIBERTY LOBBY, INC., 477 U.S. 242, 249 (U.S. 1986).

5. CIFRA V. GEN. ELEC. CO., 252 F.3D 205, 216 (2D CIR. 2001) (CITATIONS OMITTED).

Heightened Federal Pleading Requirement Results in Delaware Bankruptcy Court Dismissing Federal and California WARN Act Complaint in AFA Investment, Inc., et al. Bankruptcy

In the Delaware state courts, a complaint or other initial pleading, and any answer or responsive pleading thereto, are normally considered sufficient if the allegations contained in the document provide enough detail to put the other party on notice of the of the respective claims or defenses of the opposing party. This is commonly referred to as "notice pleading." In the not too distant past, notice pleading was what was required in the federal court system as well. Two (2) relatively recent decisions of the United States Supreme Court now require a heightened standard of pleading in the federal courts. *See Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007); *Ashcroft v. Igbal*, 556 U.S. 662 (2009). The class action suit filed by Nadia Sanchez ("Sanchez") against AFA Foods, Inc. ("AFA Foods"), AFA Investment, Inc. ("AFAI," and collectively with AFA Foods, the "Debtors") and Yucaipa Corporate Initiatives Fund II, LLC ("Yucaipa"), Adversary Proceeding No. 12-50710 in the United States Bankruptcy Court for the District of Delaware, is a good case study for the applicability of the heightened pleading standard now required in the federal courts.

On April 2, 2012, AFA Foods, AFAI and several related entities filed bankruptcy in Delaware. Yucaipa owns AFAI, which in turn wholly owns AFA Foods. AFA Foods and its subsidiaries were one of the largest distributors of ground beef and hamburger patties in the country. AFA Foods had facilities located in California, Georgia, New York, Pennsylvania, and Texas. In March 2012, there was media and public uproar over the use of boneless lean-beef trimmings, aka "Pink Slime," by AFA Foods in some of its various products. The economic backlash against Debtors lead to the Debtors filing for bankruptcy protection and selling substantially all of their assets pursuant to Section 363 of the Bankruptcy Code. The Debtors' asset sales were conducted through two (2) auctions that took place in Delaware and New York.

As part of the bankruptcy process, after the bankruptcy petitions were filed in April, the Debtors reduced the amount of people it employed at some of its facilities. Sanchez worked at the AFA Foods' facility located in Los Angeles, California. She was one of the many workers who had their employment terminated by the Debtors. On May 10, 2012, Sanchez filed a Class Action lawsuit (the "Complaint"). In the Complaint, Ms. Sanchez alleged that she and approximately 200 other similarly situated employees at Debtor's plants were terminated without notice in violation of both the federal Worker Adjustment and Retraining Notification Act (the "WARN Act") and the California Labor Code (the "California WARN Act"). On August 8, 2012, Yucaipa filed a Motion to Dismiss the Complaint for failure to state a claim upon which relief could be granted (the "Motion"). The Honorable Mary F. Walrath heard the Motion and issued a Memorandum Opinion (the "Memorandum Opinion") and separate Order (the "Order") both dated December 14, 2012 granting Yucaipa's Motion and dismissing the Complaint. Judge Walrath allowed Plaintiff thirty (30) days from the date of the Order to file an amended Complaint to try to cure the pleading defects of the Complaint and survive a motion to dismiss. The thirty (30) days expired on January 14, 2013. Upon review of the docket, Sanchez has not filed an amended Complaint within the time frame allowed by the Court.

As stated above, the U.S. Supreme Court's decisions in *Twombly* and *Igbal* created heightened pleading standards in the federal courts. To meet the new standard, a complaint is required to state "sufficient factual matter, accepted as true, to state a claim to relief that is

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"THE U.S. SUPREME COURT'S DECISIONS IN *TWOMBLY* AND *IGBAL* CREATED HEIGHTENED PLEADING STANDARDS IN THE FEDERAL COURTS"

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a position of relative weakness, or proceed with the costly process of discovery and/or trial.[6]

III. The Breach of Contract Claim and its Shortcomings when it comes to Summary Judgment.

In order to recover a debt through litigation, the unsecured trade creditor will normally be suing for "breach of contact." To get summary judgment on a breach of contract claim, a creditor must show there is no genuine issue for trial concerning "(1) the existence of an agreement, (2) adequate performance of the contract by the [creditor], (3) breach of contract by the defendant, and (4) damages."[7]

Creditors will normally have no problem with the first, third, and fourth requirements. It's the second requirement that can turn what should be a simple collection action into a litigation nightmare involving protracted discovery and possibly even a trial.

After being sued, even the most honorable debtor will, on the advice of counsel, assert that the unpaid goods were defective, delivered late, or that the creditor did not adequately perform the contract for some other reason. However, these claims are often belied by an extremely common fact pattern that occurs before many collection lawsuits are commenced.

Especially in the context of a delinquent account, it is not unusual that unpaid shipments will have been delivered over a period of several months or more. By the time a lawsuit is commenced, several more months have usually passed. Typically, during that time period, you will have demanded payment and the debtor will simply have ignored you.

This fact pattern can have immense legal significance if the creditor has been maintaining a proper documentary record.[8] If you have taken the time to communicate with your debtor via email instead of phone – always being cognizant of the fact your emails may ultimately end up in front of a Judge – you may have compelling proof to offer in support of summary judgment. Indeed, any email communication, regardless of its content, can be used as proof that a creditor has adequately performed its contract.

For example, it can be a game-changer at summary judgment if a creditor is able to swear in a declaration that:

The goods for which the debtor failed to pay were shipped between January and June 2012. During that six month period, I sent 40 emails to the debtor concerning various issues relating to the account. I received a total of 30 replies ranging from requests for extensions of payment dates, to details of the debtor's planned vacation in Italy. Never once, throughout this entire time, did the debtor complain about the quantity or quality of the goods.

Of course, the debtor can respond by claiming he complained about quality over the phone. However, it's implausible that a debtor who genuinely received defective goods would have been responding to emails from a creditor with anything other than complaints at the time the allegedly defective goods were received.

In the context of summary judgment, "[o]nce the moving party" – in this case the creditor – "meets its initial burden[,]…the burden shifts to the nonmoving party to demonstrate that there exist genuine issues of material fact."[9] "[M]ere conclusory allegations or denials…cannot by themselves create a genuine issue of material fact where none would otherwise exist."[10] Indeed, the debtor "must offer some hard evidence showing that its version of the events is not wholly fanciful."[11]

The burden these standards place on the debtor are in some tension with the Supreme Court's admonition that "at the summary judgment stage the judge's function is not himself to weigh the evidence…but to determine

6. IT SHOULD BE NOTED THAT WHERE A CREDITOR IS SUING SOMEONE OTHER THAN ITS CUSTOMER, SUCH AS THE CUSTOMER'S SHAREHOLDERS OR THE TRANSFEREE OF A FRAUDULENT CONVEYANCE, INTENSIVE DISCOVERY WILL BE UNAVOIDABLE. PROSECUTING THOSE TYPES OF ACTIONS IS BEYOND THE SCOPE OF THIS ARTICLE.

7. HARSCO CORP. V. SEGUI, 91 F.3D 337, 348 (2D CIR. 1996).

8. THE UCC MAY ALSO PROVIDE A CREDITOR WITH PROTECTIONS IN THIS SCENARIO. FOR EXAMPLE, UCC § 2-602(1) REQUIRES THAT GOODS MUST BE REJECTED "WITHIN A REASONABLE TIME AFTER THEIR DELIVERY[.]" IF, HAVING HAD A REASONABLE OPPORTUNITY TO INSPECT THE GOODS, THE BUYER FAILS TO REJECT THEM IN ACCORDANCE WITH UCC § 2-602(1), THEY ARE DEEMED TO HAVE BEEN ACCEPTED UNDER UCC § 2-606 (1)(B). ACCORDING TO UCC § 2-607 (1), THE EFFECT OF ACCEPTANCE IS THAT THE BUYER MUST PAY THE CONTRACT RATE FOR THE GOODS.

9. NATIONSCREDIT COMMER. CORP. V. MATLOCK, 2000 U.S. DIST. LEXIS 12211, *9 (S.D.N.Y. 2000) (CITING MATSUSHITA ELEC. INDUS. CO. V. ZENITH RADIO CORP., 475 U.S. 574, 586-587 (U.S. 1986)).

10. HICKS V. BAINES, 593 F.3D 159, 166 (2D CIR. 2010).

11. GOLDEN PAC. BANCORP V. FDIC, 375 F.3D 196, 200 (2D CIR. 2004) (CITATION OMITTED); SEE ALSO NATIONSCREDIT COMMER. CORP. V. MATLOCK, 2000 U.S. DIST. LEXIS 12211, *9 (S.D.N.Y. 2000) ("THE NONMOVING PARTY…MUST SET FORTH 'CONCRETE PARTICULARS' SHOWING THAT A TRIAL IS NEEDED.") (QUOTING R.G. GROUP, INC. V. HORN & HARDART CO., 751 F.2D 69, 77 (2D CIR. 1984)).

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whether there is a genuine issue for trial." [12] How can a Judge characterize a debtor's claims as "wholly fanciful" without, at least to some degree, weighing the evidence?

However, facts win cases; not law. Most Judges will latch onto any case-law that lets them do whatever they intuitively wanted to do in the first place. Thus, a carefully documented debtor/creditor relationship may be the difference between a Judge awarding pre-discovery summary judgment, and a creditor having to shell out on legal fees to go forward with discovery, depositions, and possibly even a trial.

IV. The "Account Stated" Claim and Its Importance for the Unsecured Trade Creditor

Apart from the standard breach of contract claim, there is another claim that may be used to great effect as a means to getting pre-discovery summary judgment. That claim is called "account stated," and exists in one form or another in most states. The New York Court of Appeals has described an account stated claim as follows:

> "As a general rule, where an account is made up and rendered, he who receives it is bound to examine the same, or to procure someone to examine it for him. If he admits it to be correct it becomes a stated account, and is binding on both parties. If, instead of an express admission of the correctness of the account, the party receiving it keeps the same by him and makes no objection within a reasonable time, his silence will be construed into an acquiescence in its justness, and he will be bound by it as if it were a stated account. An account stated is conclusive upon the parties, unless fraud, mistake, or other equitable considerations are shown, which make it improper to be enforced."[13]

The beauty of the account stated claim is that, unlike a breach of contract claim, the creditor doesn't have to prove that it adequately performed the contract. Instead, it just has to prove that the debtor received its invoices and didn't object within a reasonable time.[14]

Unfortunately, many creditors are unable to avail themselves of an account stated claim for the simple reason that they can't definitively establish that the debtor "received" their invoices. This situation could easily be avoided by emailing invoices to debtors and requesting read-receipts for the emails. In addition, where possible, officers of debtors should be copied on these emails or copies of invoices should be mailed to the debtor's officers by certified mail with a return receipt requested or by FedEx with a signature required.

If this is done, a creditor may be able to avoid the inevitable defective product allegations that are asserted in response to a breach of contract claim, and obtain pre-discovery summary judgment on their account stated claim instead.

Conclusion

Prudent credit professionals should maintain a checklist for each customer account indicating whether invoices have been mailed and emailed, whether read-receipts and certified mailing receipts have been received, and whether signed proofs of delivery have been obtained. All these documents should be saved in PDF format so that they can be emailed to counsel on short notice. And where this procedure is not practicable, such as where a creditor ships a large number of separate orders, it should at least be followed for high value shipments or problem accounts. Comprehensive documentary records mean fewer triable issues of fact, and fewer triable issues of fact mean more collections and less litigation.

12. Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 249 (U.S. 1986).

13. Rodkinson v. Haecker, 248 N.Y. 480, 485 (1928) (underlining added). Under California law "[t]here are three essential elements of a claim for account stated: (1) previous transactions between the parties establishing the relationship of debtor and creditor; (2) an agreement between the parties, express or implied, on the amount due from the debtor to the creditor; (3) a promise by the debtor, express or implied, to pay the amount due. The key element in every context is agreement on the final balance due. In the usual situation, it comes about by the creditor rendering a statement of the account to the debtor. If the debtor fails to object to the statement within a reasonable time, the law implies his agreement that the account is correct as rendered."

Starnet Int'l AMC Inc. v. Kafash, 2011 U.S. Dist. LEXIS 25062, *30-31 (N.D. Cal. 2011) (applying Californian law, citations and quotations omitted, underlining added).

14. Cf. Neuman Distributors, Inc. v. Falak Pharmacy Corp., 289 A.D.2d 310, 311 (2d Dep=t 2001) (holding that summary judgment on claim for account stated was proper where "the plaintiff presented, inter alia, itemized invoices, credit memos, and corresponding signed delivery receipts for the merchandise previously delivered.")

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request for adequate protection as follows:

> [A]dequate protection analysis requires the bankruptcy court to first determine when the creditor <u>would have obtained its state law remedies had bankruptcy not intervened</u>. Presumably, that will be after the creditor first seeks relief. The court must then determine the value of the collateral as of that date… The amount by which the collateral depreciates from that valuation is the amount of protection adequate to compensate the creditor for the loss occasioned by bankruptcy. *Id.* (emphasis added)

Of course, depreciation of Paccom's equipment, as with equipment generally, was occurring in accordance with a specific set of accounting rules. Thus, fashioning an adequate protection remedy could be achieved with relative ease once the Court made its determination of when Paccom "would have obtained its state law remedies." But the BAP recognized that the question may not always be so simple when it stated that:

> [C]ollateral may not always depreciate according to a precise monthly schedule… Therefore, while the amount of adequate protection to which an undersecured creditor is entitled is equal to the amount of depreciation its collateral suffers <u>after it would have exercised its state law remedies</u>, neither that determination nor the schedule for its tender are appropriate for application of a rigid formula. Instead, the bankruptcy court must have discretion to fix any initial lump sum amount, the amount payable periodically, the frequency of payments, and the beginning date, all as dictated by the circumstances of the case and the sound exercise of that discretion. *Id.* (emphasis added)

With the greatest of respect to the BAP, this description hardly provides much guidance to bankruptcy courts. It articulates a specific rule, states that the rule's application is not susceptible to a "rigid formula," and then gives no examples of how it might be practically applied. And as complicated as this approach is to begin with, it is made more ambiguous by the tension between the underlined language in the two paragraphs quoted above, and the ambiguity of those phrases. Is there a difference between when a secured creditor "exercises" its state law remedies and when it "obtains" its state law remedies? And what do either of these terms really mean in practical terms? The answers would become somewhat clearer a mere 18 years later in *Big3D*.

Big3D

In the years between *Deico* in 1992 and *Big3D* in 2010, a broad consensus had emerged nationally that the date adequate protection is requested marks the point from which depreciation (and therefore appropriate compensation) is measured. Though imperfect, and not directly addressing the delay occasioned by bankruptcy, it is a rule that can be applied easily. The value of such easy application cannot be dismissed lightly in the overall context of bankruptcy, where decisions about adequate protection often need to be made quickly in conjunction with a range of other problematic decisions, all while attempting to give the debtor its breathing space and creditors due process. The BAP had also agreed to convene an expanded *en banc* panel to hear the *Big3D* appeal. The stage seemed to be set for the BAP to reconsider the wisdom of *Deico*, and bring itself into line with the majority of circuits.

The secured creditor in *Big3D* was again an equipment leasing company, PCLC, which was

"DECISIONS ABOUT ADEQUATE PROTECTION OFTEN NEED TO BE MADE QUICKLY IN CONJUNCTION WITH A RANGE OF OTHER PROBLEMATIC DECISIONS"

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able to show that its collateral was depreciating. But although the collateral at issue was similar, *Big3D* had an added wrinkle. Two days prior to the bankruptcy filing, PCLC had successfully obtained a writ of possession from a California state court, a prejudgment remedy giving PCLC authority to repossess its collateral with the assistance of the county sheriff. PCLC was consequently in a position to argue that it had "exercised" or even "obtained" its state law remedy, and should immediately receive adequate protection payments under *Deico*.

Two thirds of the *en banc* panel disagreed, and held that while *Deico* still applied, PCLC had not in fact exercised its state law remedies. It held that:

> While PCLC had obtained a state court order directing the sheriff to take possession of the Equipment on PCLC's behalf, PCLC would not have fully "exercised" its remedies under its contract and applicable state law until the Equipment was actually repossessed and sold. It is only at that point that the value of the Equipment would have been converted to cash, and PCLC's security would be immune from any future decline in value.

This at least resolved the ambiguities of the *Deico* opinion by equating the "exercise" of state law remedies with the conversion of collateral to cash. Nonetheless, such a determination still involves a minefield of hypotheticals and speculative assumptions, which is evident just from the BAP's own analysis of when PCLC would have converted its equipment to cash. Addressing some of the hypothetical difficulties PCLC might have faced, the decision continued:

> But even assuming the best possible circumstances, and the efficient execution of the repossession and sale of the Equipment, it likely would have taken PCLC substantial time to have removed and sold the Equipment following the state court's issuance of a writ of possession… For example, even if the sheriff had acted to enforce the writ on the same day Big3D filed its bankruptcy petition, it is likely that the disassembly and removal of the Equipment would have taken some time to accomplish… The bankruptcy court noted that the Equipment was a large piece of specialized machinery, not easily movable, and that the physical removal of the Equipment would require a team of technicians at least several days. The Equipment would need to be dismantled and transported in pieces to another location.

Id. at 222-223

The BAP also detailed some of the procedural roadblocks that the debtor might be able to put up under the writ of possession statute, which were potentially significant. All of which pointed to a surprisingly convoluted analysis notwithstanding that: (1) the collateral at issue is about as straightforward as a piece of non-cash collateral gets; (2) the secured creditor had already chosen its state court remedy prepetition; and (3) the state court had already issued it. Even beginning with this well-defined starting point, the BAP had identified multiple complicating factors. However, the variables become infinitely more complicated when a secured creditor has taken no action at all to exercise its remedies prepetition.

Exponential Complications

For example, suppose a debtor (D) runs a farm, and a creditor (C) has a blanket lien over all of the farm's assets including its herd of cattle. Outside of bankruptcy, C might seek a writ of possession if D is in default, but it might also seek to appoint a receiver over the

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"THE VARIABLES BECOME INFINITELY MORE COMPLICATED WHEN A SECURED CREDITOR HAS TAKEN NO ACTION AT ALL TO EXERCISE ITS REMEDIES PREPETITION"

Johnny White, Esq.

It's Complicated: Revisiting *BIG3D* and *DEICO's* Inadequate Guidance for Adequate Protection

(Continued from page 9)

herd. How does the bankruptcy court account for this choice? It could make an informed guess as to which of these remedies C would have resorted to and then decide how long that remedy would take to obtain. Equally though, it could analyze both remedies, decide the respective probability of obtaining each, and then make a weighted average calculation as to when the collateral would be converted to cash. However, if it does the latter, it presumably also has to give probabilistic weight to the costs of the respective remedies. Appointing a receiver may be significantly more expensive, and this has to be accounted for in the bankruptcy court's blended calculation.

The uncertainties by no means end there. One obvious question is: how favorable should the court's hypothetical analysis be to D? When assuming that C would have to file a lawsuit in state court in order to recover its collateral, should the court assume that D would answer the complaint within 30 days? Or might it assume (as commonly occurs) that D successfully negotiated an extension of time to file an answer? Can it assume that C would succeed in having relief granted on an *ex parte* basis? Or should it assume a noticed motion 16 court days' after D answers the complaint? Then there is the question of: how much weight should be given to the proliferation of over-congested calendars and (sometimes arbitrary and unpredictable) procedural stumbling blocks?

This latter question takes on heightened significance in the context of California's budgetary struggles, and the impact this has had on all aspects of the court system. C could expect delays in having its motion for a writ of possession heard, in having its writ processed by the clerk's office, and having it enforced by the sheriff. On the one hand, this all factors in to C's ability to liquidate its collateral outside of bankruptcy, and there is no logical reason why it should be excluded from the pertinent calculation. On the other hand, as the policy behind bankruptcy is to facilitate an orderly winding up of a debtor's affairs, it seems intuitively wrong to draw standards from the unwitting dysfunction of underfunded state courts.

Finally, there is at least one further factor that makes the entire analysis close to imponderable. Looming large in any state court litigation with a financially distressed defendant is the prospect of bankruptcy. How should the bankruptcy court account for the threat of bankruptcy in a hypothetical which assumes that bankruptcy did not occur? In the example above, C might simply decide to sweep D's accounts and not allow it to feed its cattle. If the collateral is dying, C would presumably then have a strong case for emergency relief from a state court. However, this kind of drastic and commercially unreasonable behavior might frequently result in a debtor filing bankruptcy to elicit automatic stay protections, and it is unclear from *Deico* or *Big3D* whether the bankruptcy court can, or how it should, take account of this.

Conclusion

In summary, while the goal of *Deico* and *Big3D* – to accurately distill the actual prejudice suffered by a secured creditor as a result of the delay caused by bankruptcy – is laudable, it should be abandoned. The test requires bankruptcy courts to imagine how a secured creditor would have gone about exercising its state court remedies, with no boundaries on what influences this imaginary narrative. It is simply fraught with practical difficulty to the point of being unworkable. Even within the relatively straightforward setting of equipment leasing, the BAP's own decisions demonstrate the almost overwhelming complications a judge faces. Given this, it is likely that the test is being ignored as often as it is applied, particularly when it cloaks the lower courts with "broad discretion." A flawed bright -line rule in keeping with the majority approach would be preferable, and *Big3D* was an opportunity missed to introduce one.

Garnishing An Out-of-State Bank Account? Yes, It May Be Possible

(Continued from page 1)

banks were state chartered, their funds were held at the branch level. As a result, a judgment creditor's levy had to be branch specific. Specifically, Commercial Code § 4107 provides that "A branch or separate office of a bank is a separate bank for the purpose of computing the time within which and determining the place at or to which action may be taken or notice or orders shall be given under this division and under Division 3 (commencing with Section 3101)."

But in the mid to late 1980s, the banking industry went through major changes, with many banks consolidating or merging. In response, in1994, Congress passed the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (IBBEA) which was codified to 12 U.S.C. § 1811, which in general was designed to make branch banking more efficient by nationalizing the process for national banks, and regulating state chartered banks that wanted to expand to different host states. As result, national banks went to a state depository framework, with each state having its own depository network, and a levy within the state would capture all accounts in every branch within that State.

In 2004, The Department of the Treasury issued Regulation 12 C.F.R. 7.4007, which authorized national banks to take deposits without regard to state law. Therefore many national banks have created a single depository framework, rather than dividing the accounts into a patchwork of 50 depositories. As part of that process, many banks inserted into its account agreement a provision which allows the bank to maintain a single set of books and to honor levies on a national basis. As been recently explained to me by a national bank, the bank "does not maintain 50 mattresses, one for each state, each with money in it. Rather, it maintains a single mattress for the entire bank."

What if your judgment debtor uses a state chartered bank with locations in different states, including the state where the judgment was entered? While not universally held, courts have determined that a bank does not have physical custody of a depositor's money at a particular site. Instead, a general deposit into a bank account creates a debt owed by the bank to the depositor. As a result, the judgment creditor can assert that it is the receivable owed by the bank that is being collected, not the actual funds, that provides the basis for recovery.

In the end, we ask do the outcomes described above make common sense? The fact that Congress authorized the Department of the Treasury to allow national banks to do the same is sound in today's national, if not global, economy. Additionally, the principle that the corporation could do business across state lines, but insulate itself from a single levy makes little sense.

Critics may argue that the judgment debtor's account is physically located in its home state where it was opened, and the garnishment should not reach the funds in the account. Those same critics may assert that the judgment creditor should simply domesticate the judgment in the judgment debtor's home state pursuant to full faith and credit, and garnish in that state. In practice, however, in most states the judgment debtor would have notice of the domestication and be afforded an opportunity to move the funds before the garnishment took place. In the end, whether using the theory of a single depository or a bank receivable, judgment creditors and the overburdened legal system are benefited by the ability to garnish against a bank with locations in their home state.

Bradley D. Blakeley, Esq.

"WHILE NOT UNIVERSALLY HELD, COURTS HAVE DETERMINED THAT A BANK DOES NOT HAVE PHYSICAL CUSTODY OF A DEPOSITOR'S MONEY AT A PARTICULAR SITE"

Peter M. Sweeney, Esq.

Heightened Federal Pleading Requirement Results in Delaware Bankruptcy Court Dismissing Federal and California WARN Act Complaint in AFA Investment, Inc., et al. Bankruptcy

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plausible on its face." *Igbal*, *556*, U.S. at 678 (quoting *Twombly*, 550 U.S. at 570). A claim is facially plausible "when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Id.*; *see Memorandum Opinion*, p. 4. On the other hand, if a pleading only provides labels, conclusory statements, or only states the general elements required for a cause of action, then the pleading will not be sufficient to meet the new federal requirements. *See Fowler v. UPMC Shadyside*, 578 F.3d 203, 210 (3d Cir. 2009) *citing Twombly*, 550 U.S. at 555); *Memorandum Opinion*, at 4.

Courts are asked to review a complaint within the context of the case and draw on their "judicial experience and common sense" in determining whether a particular pleading has met the new federal standards. *See Igbal*, 556 U.S. at 679. Still, "where the well - pleaded facts do not permit the court to infer more that the mere possibility of misconduct, the complaint has alleged – but it has not shown – that the pleader is entitled to relief." *Id.; Memorandum Opinion*, at p. 5.

Judge Walrath sets forth the Third Circuit analysis in her Memorandum Opinion, "The Third Circuit has instructed courts to conduct a two-part analysis. *Fowler*, 578 F.3d at 210. 'First, the factual and legal elements of a claim should be separated,' with the reviewing court accepting 'all of the complaint's well-pleaded facts as true, but . . . disregard[ing] any legal conclusions.' *Id.*, at 210-11. Next, the reviewing court must 'determine whether the facts alleged in the complaint are sufficient to show that the plaintiff has a plausible claim for relief.' *Id.*" *See Memorandum Opinion,* at 5.

Sanchez in her class action Complaint facially alleges that the Debtors and Yucaipa are both liable for breach of the WARN Act and Cal WARN Act because (i) the Debtors and Yucaipa are a single employer and (ii) the terminated employees did not provided 60 day advanced written notice of the termination as required by the WARN Act and Cal WARN Act. Yucaipa's Motion to Dismiss challenged that Sanchez alleged sufficient facts in the Complaint that Yucaipa and the Debtors were a single employer or that the Debtors terminated enough employees to reach the required levels to qualify as a mass layoff under the applicable state and federal WARN acts.

"The Third /Circuit has adopted a five factor balancing test for determining whether related companies are liable under the WARN Act on "single employer" grounds. The five factors are: '(1) common ownership, (2) common directors and/or officers, (3) de facto exercise control, (4) unity of personnel policies emanating from a common source, and (5) dependency of operations." *In re APA transport Corp. Consol. Litig.*, 541 F.3d 233, 243 (3d Cir. 2001) (citing *Pearson v. Component Tech. Corp.*, 247 F.3d 471, 494 (3d Cir. 2001), *Memorandum Opinion*, p. 6-7. Each of these five factors are not given the same weight when analyses by a court. Further, the Third Circuit has determined that the factors cannot be established just by the exercise of "ordinary powers of ownership" by the management of the corporation. *Id.* (citations omitted).

In the Memorandum Opinion, Judge Walrath's analysis goes into great detail discussion the factual allegations of Sanchez's Complaint and whether said allegations are sufficient to establish that Yucaipa and the Debtors were a "single employer" for WARN Act purposes. Sanchez's Complaint only tracks the language of the required elements for a "single employer." *See Memorandum Opinion*, p. 7.

Heightened Federal Pleading Requirement Results in Delaware Bankruptcy Court Dismissing Federal and California WARN Act Complaint in AFA Investment, Inc., et al. Bankruptcy

(*citing* Adv. D.I. 1 at ¶ 37). Sanchez relies upon case law decided prior to the U.S. Supreme Court deciding the *Twombly* and *Igbal* cases, namely *Hiles v. Inoveris*, No. 2:09-CV-53, 2009 WL 3671007, at *4 (S.D. Ohio Nov. 4, 2009), to argue that the Complaint should not be dismissed prior to allowing her to take discovery. Judge Walrath followed controlling precedent in ruling that, "The law is clear that Sanchez should not be permitted to take discovery until she properly pleads a plausible cause of action." *See Igbal*, 556 U.S. at 678-79 (other citations omitted).

The common ownership between Yucaipa and Debtors and the common officers and directors between them as well was alleged by Sanchez in her Complaint as the factual basis to assert the single employer theory. Walrath stated that "ownership – and even ownership coupled with common management – is not a sufficient bases for [WARN Act] liability. *See Memorandum Opinion*, p. 10, *citing Pearson*, 247 F.3d at 494. Sanchez also attempted to establish that Yucaipa exercised de facto control over the Debtors and made the employment decisions. *Id., at p. 10-11.*

Ultimately, the Court found repeatedly that Sanchez's Complaint did not contain sufficient factual allegations, beyond simple conclusory statements to list the elements of the "single employer" theory, to survive Yucaipa's Motion to Dismiss. Specifically, the Court stated, "Sanchez, however, does not allege any specific facts showing how Yucaipa controlled the decision-making process. Simply stating that Yucaipa made the decision to order the mass layoff is insufficient." *Id.*, at p. 11. The Court made similar analysis concerning Sanchez's attempts at establishing the other elements of the "single employer" theory, stating "Thus, the Complaint does not support the conclusion that Yucaipa and the Debtors 'actually functioned as a single entity with respect to [personnel] policies on a regular, day-to-day basis.'" *Id.*, at p. 12, *citing Pearson* 247 F.3d at 490. "The Court finds that the allegations of the Complaint are bald assertions of the corresponding legal factors and do not provide a basis from which the Court can infer the high degree of integration required under *Pearson*. Thus, it is not plausible from the allegations stated in the Complaint that the Debtors relied on Yucaipa for day-to-day operations or that Yucaipa controlled the Debtor's business in something more that an investor's role." *Id.*, at 13 (citations omitted). The Court also found that Sanchez did not meet the pleading requirements to establish a mass layoff under the WARN Act. *Id.*, at p. 14. ("The Court agrees with Yucaipa that Sanchez may not aggregate layoffs from several different sites of employment in order to meet the statutory minimum of 50 employees. *See, e.g., Williams v. Phillips Petroleum* Co., 23 F.32 930, 934 (5th Cir. 1994)").

The heightened pleading standards required by the federal courts must be taken into consideration prior to filing a complaint. Mere recitation of the elements of a cause of action will not be sufficient to survive a motion to dismiss. The complaint must state enough facts to establish a plausible cause of action to survive a motion to dismiss, as discovery will not be allowed to establish those facts. Any potential plaintiff will need to spend time gathering the necessary facts in preparation for the initial meeting with an attorney to discuss the drafting and filing an action in federal court. Time spent gathering the necessary facts at the beginning will save time and expense later when faced with a motion to dismiss for failure to state a claim.

"THE HEIGHTENED PLEADING STANDARDS REQUIRED BY THE FEDERAL COURTS MUST BE TAKEN INTO CONSIDERATION PRIOR TO FILING A COMPLAINT"

Scott E. Blakeley, Esq.

Self-help to Setoff A Delinquent Account: A Reminder of Legal Boundaries

(Continued from page 1)

"THE PURPOSE OF THE AUTOMATIC STAY IS TO GIVE THE DEBTOR BREATHING ROOM, AND TO PROTECT CREDITORS FROM EACH OTHER"

As with any risk mitigating strategies, they must be considered within the context of their legal requirements, and court decisions often more clearly define these as in the Chapter 11 filing of clothing retailer Betsy Johnson.

The Trade Relationship

H&S Fashion (the vendor) provided sewing services to the debtor, a national clothing retailer. As part of the prepetition contract with the debtor, the vendor obtained fabric owned by the debtor for its manufacturing. The vendor would ship its finished product to the debtor's stores on credit terms. The debtor failed to pay the vendor for its services. The debtor was forced to file chapter 11 because of a downturn in sales. At the time of the chapter 11 filing, the debtor owed the vendor $80,000. The vendor was holding the debtor's materials with an invoice value of $300,000 at the time of the chapter 11 filing.

The debtor sent a demand letter to the vendor seeking recovery of this material, as well as any proceeds. The vendor did not respond. The debtor sued the vendor, claiming the vendor improperly sold the debtor's fabric in violation of the automatic stay. The debtor's lawsuit alleged that on the same day the demand letter was sent, a representative of the debtor entered the vendor's factory and saw some of the fabric in the vendor's possession. The vendor allegedly sold the fabric and kept the proceeds.

The debtor requested that the court require the vendor to deliver the value of the inventory that the vendor has in its possession. The debtor contended that since the fabric was property of the bankruptcy estate, if it had been sold, the debtor was entitled to the proceeds of the sale. The debtor requested the court award punitive damages, including attorneys' fees and costs. Despite the demand letter warning regarding the automatic stay, the vendor sold the fabric. The debtor owed the vendor $80,000 for services, and not the $300,000 of the debtor's fabric sold by the vendor to setoff these past due invoices.

The Automatic Stay

The automatic stay is an injunction that arises when a debtor filed bankruptcy. The automatic stay prohibits a creditor from taking action against property of the debtor, unless relief from stay is obtained. For example, a vendor is barred from seeking to collect on prepetition invoices, levying on writs of attachments as well as recording judicial liens against the debtor. The purpose of the automatic stay is to give the debtor breathing room, and to protect creditors from each other by preserving the bankruptcy estate intact until property can be distributed according to the bankruptcy priority scheme and allow an orderly administration of the case.

Damages are assessed against a creditor only where it is shown that the creditor had notice or knowledge of the bankruptcy filing. Where there is a willful violation of the stay, the court will award an individual debtor actual damages, including a debtor's attorneys fees and costs for enforcing the violation. The court may also award punitive damages to punish the creditor.

Property of the Estate

While the automatic stay bars a creditor from collecting against property of the estate, what is property of the estate? The Bankruptcy Code defines property of the bankruptcy estate to include all assets of the estate, both tangible and intangible, at the time of the bankruptcy filing. Property of the estate includes the debtor's product held by the vendor as part of the manufacturing process, as was the case here.

Limits to Setoff

The Bankruptcy Code provides that in certain settings a vendor may setoff the debt it owes the vendor with the debt the debtor owes it. The elements of a setoff are: (1) the creditor holds a claim against the debtor that arose

Self-help to Setoff A Delinquent Account: A Reminder of Legal Boundaries

before the commencement of the bankruptcy; (2) the creditor owes a debt to the debtor that also arose before the commencement of the bankruptcy; (3) the claim and debt are mutual; and (4) the claim and debt are each valid and enforceable. Setoff, in effect, elevates an unsecured claim to secured status, to the extent that the debtor has a mutual, prepetition claim against the creditor. However, once a debtor has filed bankruptcy the creditor must obtain relief from the automatic stay from the bankruptcy court. The vendor did not seek court authorization for setoff, but took the opposite approach by secretly disposing of the inventory, inventory that supposedly had four times the value of the vendor's debt.

Note that the vendor failed to respond to the debtor's lawsuit for turnover of the fabric, or the proceeds from the sale of the fabric. The debtor moved for a default, seeking a judgment for the invoice amount of the fabric, disallowance of the vendor's claim, attorney's fees and damages for violating the automatic stay.

Reminder to Vendor

The creativity of the credit professional in finding ways to reduce credit risk and mitigate losses with a delinquent account should be applauded. However, as the Betsy Johnson lawsuit highlights, there are legal limits the credit professional needs to evaluate when attempting to setoff its bankruptcy loss.

If you have a customer that files chapter 11, and that customer has a balance owing you, as well as you owe the customer, say for credits that have accrued, consider next steps. Request the debtor file a motion authorizing you to set off your prepetition debt with the balance owed the debtor.

Credit Managers You Can Be a Hero: Contribute to Your Company's Revenue and Profit Performance

Robert S. Shultz

(Continued from page 2)

4. Have you examined your targets and objectives to determine if they measure what is truly important to the company and profit objectives?

5. Do you help identify issues and improve broken processes and control procedures beyond the walls of your department?

6. Do you communicate the "why of your decisions? What are the risks and opportunities for the company to keep or gain market share? Identify the customers or channels with the highest growth "risk vs. reward" potential? Integrate credit and collections policies and controls with sales and marketing strategies?

Get the Basics in Place

Before we get into specifics about how a Credit Manager can help drive revenue growth, there are preparatory steps that must be in place.

Establish the Credit Collections Department as a Profit Center

It is an unfair assumption that credit risk and collections management is an isolated overhead necessity. The department is an integral part of the company's working capital engine needed to meet financial goals. Put the department's value in a context. Credit and collections is a critical part of the quote to cash process. The department touches processes involving Sales, Operations, customer Service, Accounting and Finance and Treasury. Properly managed each of these functions is tied together by interrelated processes, relevant "Key Performance Indicators" (KPI's) and supporting systems and information tools.

The department adds to the bottom line in three ways:

Credit Managers You Can Be a Hero: Contribute to Your Company's Revenue and Profit Performance

(Continued from page 15)

1. Credit policies and options help meet revenue and profit performance.

2. Prompt collections reduce borrowing costs.

3. Efficient processes lower overhead costs

Be Seen as an Ally to Your Sales Team

Let's Start with the Credit and Collection Policy. Sales people do not like surprises. They want a policy that is fair, consistent and therefore predictable. They want to be able to anticipate how a new account or opportunity will be handled by Credit. It starts with a well thought out credit, collection policy.

The policy should be sensitive to Sales needs, the company's overall business strategy and be in line with the company's financial objectives. Once the policy is determined and signed off by the most senior company executive it must be documented and well communicated.

Be Proactively Involved with Your Sales Team, Other Company Stakeholders and Customers

As the saying goes, "To be understood, you first have to understand." It is essential to know your Sales team and customers, their goals, concerns and challenges. This will help you prioritize your efforts to maximize revenue and profit for your company and the customer. You will be better able to offer workable alternatives and if needed, explain why some business opportunities are simply not good business for your company.

Here are several actions you can take to build these relationships:

- **Attend Sales Team meetings.** Listen first and then provide information of interest to them on opportunities and issues where their involvement can help. See if you are providing the type of reports and analysis that are truly of use to them. Encourage them to involve you as deals are being developed.

- **Do a ride along with your Sales Reps.** See how they spend their day, the questions and issues that come up.

- **Visit your customers regularly.** With the tight budgets today this can be a tough sell to your boss. There is a definite return on the customer visit travel investment. By building a relationship with your customer you will stay informed of potential risks, selling opportunities and process issues within your own company with a negative impact on customer service and profitability. By understanding their business and anticipating sales growth opportunities you can be prepared with credit risk mitigation tools to help grow the business. You become proactive, a collaborator bringing value to the table. Not the "Dr. No" of credit management lore.

- **Meet with other departments:** "Walk in their shoes". Keep up with how new initiatives may impact your department or how your policies affect other operations in the company. Cooperation between departments starts with a better understanding of what each department does and how they affect each other. Better coordination positively impacts effectiveness and the ability to drive revenue and profit.

- **Credit Mangers, listen to your staff:** They can keep you informed and help you prevent road blocks.

Focus on Sales and Profit Objectives

A good credit policy is not a revenue limiting document. It is a blueprint of how to maximize profits and manage acceptable risk. A good motto for an effective Credit Manager is:

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The Blakeley & Blakeley Quarterly is published by the law firm of Blakeley & Blakeley LLP and is distributed as a service to clients and other parties interested in creditor issues. This information is not intended to constitute legal advice, nor a substitute for legal advice.

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Credit Managers You Can Be a Hero: Contribute to Your Company's Revenue and Profit Performance

Robert S. Shultz

(Continued from page 16)

"We never say no….. We say yes, but how?" Remember true risk all boils down to two critical concerns. There may be a risk of payment delayed beyond the stated terms or there is a risk the amount owed will never be paid. Not every credit decision involves the latter. By examining the true risk it leads you to how to approach an issue and the tools you can use to get make the sale.

Think about the impact your decision has on cash flow and profit. A higher the profit potential justifies greater risk. Let's face it; in most cases extending the right amount of credit is a balancing act. Ask, over the next ninety days, what is my risk of loss or payment delay?" What profits can I generate during that time period? How much can I leave on the table and still make a profit on sales to the customer if the customer never pays? Set a credit policy that addresses the actual situation, delayed payment or risk of loss.

Conclusion: Work with your Sales team. Be seen as a partner helping to close the deals needed to make your company's revenue and profit objectives. An effective Credit Department is a profit center adding valuable self funded liquidity and improving the company's cash flow. You can be a hero by helping close profitable sales with a proactive approach and credit policies offering on-the-shelf alternatives that supplement your company' products or services.