Blakeley & Blakeley LLP

THE TRADE VENDOR QUARTERLY

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Developments in Commercial, Creditors' Rights, E-Commerce, and Bankruptcy Law of Interest to the Credit and Financial Professional

REDUCING CREDIT RISK: ARE YOUR PUBLICLY TRADED CUSTOMERS' FINANCIAL STATEMENTS MORE RELIABLE IN LIGHT OF NEW FEDERAL LEGISLATION?

A REVIEW OF THE SARBANES-OXLEY ACT OF 2002 AND WHAT IT MEANS TO THE CREDIT PROFESSIONAL

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Headlines of corporate fraud within public companies, from Enron to Adelphia to WorldCom, has prompted the U.S Congress to overwhelmingly pass federal legislation providing for accounting reform and requiring more accurate financial disclosure and reporting from public companies. This new federal legislation penetrates the area of corporate governance, which traditionally had been left to the states. President Bush has stated that corporate officers must be accountable and the integrity of financial reporting must return.

The Sarbanes-Oxley Act of 2002 (SOA) was signed into law on July 30, 2002, to combat the wave of accounting and financial reporting scandals and corporate bankruptcies. SOA focuses on the conduct of corporate officers and public accounting firms and adequate disclosure in public company financial statements. How will the law affect credit professionals and their publicly traded customers? Will the law change the way corporate officers, accountants and lawyers deal with financial disclosures? Will financial information reported by public companies become more reliable, thereby reducing credit risk for vendors selling on open account?

FEDERAL GOVERNMENT OVERVIEW

SOA provides that the Security and Exchange Commission (SEC) enforces the legislation and has earmarked $766 million for SEC enforcement. Much of this enforcement comes through SOA's creation of the Public Company Accounting Oversight Board ("Board"). The SOA grants the Board supervisory, investigative, disciplinary, and enforcement powers over public accounting firms. The board will enforce mandatory registration of firms that prepare audit reports for public companies and establish auditing, quality control, ethics and independence standards relating to preparation of audit reports. The Board must also enforce other standards that it, or the SEC, determines are "necessary and appropriate." The Board will consist of five members

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UNDERSTANDING THE ORDINARY COURSE OF BUSINESS FOR THE BANKRUPTCY PREFERENCE LAWS: WHAT IS THE INDUSTRY STANDARD?

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Your company is paid by a customer according to history of the parties. The customer, however, files bankruptcy and the trustee seeks to recapture payments during the 90 days—the preference suit. If you present the payment history of the parties, do you prevail under the ordinary course of business defense? Perhaps not, reasoned the Fifth Circuit Court of Appeals in *In re Gulf City Seafoods, Inc.,* 2002 WL 1362880 (C.A.5-Miss.).

The Bankruptcy Preference

The Bankruptcy Code vests the debtor (or trustee if one is appointed) with far-reaching powers to avoid payments prior to a bankruptcy filing. The power to avoid preferential transfers is one of the most powerful weapons a trustee has. The Bankruptcy Code defines a preference expansively to include nearly every transfer by an insolvent debtor 90 days prior to bankruptcy.

The purpose of the preference provision is two-fold. First, unsecured creditors are discouraged from racing to the courthouse to dismember a debtor, thereby hastening its slide into bankruptcy. Second, a debtor is deterred from preferring certain creditors by the requirement that a creditor

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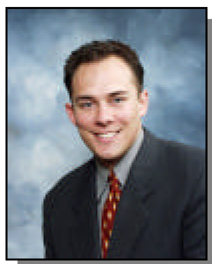
ESCHEATMENT



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This may come as a surprise if your customer's dormant accounts are used as a source of revenue—it is likely, and in fact inevitable, that those funds must be remitted to the state or federal government. This procedure is known as "escheatment," which has amassed billions of dollars of unclaimed property to state coffers.

Theory of Escheatment

The theory of escheatment provides that until the rightful owner is located, all citizens of the state, rather than an individual holder, derive benefits from the unclaimed property. Unclaimed property law finds its genesis in early English common law where unclaimed property would escheat, or revert, to the king upon abandonment. In modern times, a custodial theory has replaced confiscation. In the United States, the laws of the individual states govern abandoned property and escheatment. The meaning of escheatment has broadened to include property of every kind and description that remits to the state for want of individual ownership. Accordingly, the definition of unclaimed property involves hundreds of categories of property. As a rule of thumb, if a person or entity has a legal or equitable right to the property, then a state's unclaimed property law governs it.

The Uniform Laws and Purpose of Escheatment

Congress enacted several uniform laws to control the disposition of unclaimed property among the various states. The most recent legislation is the Uniform Unclaimed Property Act of 1995 (the "1995 Act"). The Uniform Unclaimed Property Act of 1981 and the Uniform Disposition of Unclaimed Property Act of 1954 preceded the 1995 Act. Portions of the uniform laws have been enacted by every state, the District of Columbia, and Puerto Rico. The purpose of the unclaimed property laws have remained constant—to reunite owners with their property, limit the liability of the holder of unclaimed property, and to provide states with a stream of income.

Reporting Requirements

If property remains unclaimed for a certain period of time, known as the "dormancy period," then a state gains derivative rights to the unclaimed property. The dormancy period is defined by state law and is measured by the date that the holder comes into possession of the unclaimed property and the date that the property must be reported to the state. A majority of states follow the 1995 Act and mandate that any money or credits owed to a customer has a dormancy period of three years. However, the dormancy period may range between one year and five years.

As a general rule, the owner's domicile governs a state's rights to succession of unclaimed property. The primary rule requires reporting the last known address of the owner as documented by the holder's books and records. If the identity and address of the owner is not known, then the secondary rule awards the right to escheat to the holder's state of corporate domicile. It is important to note that the holder's corporate domicile governs which property is required for reporting purposes, not the owner's domicile.

Under limited circumstances, a holder may deduct charges to maintain the

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FROM THE PUBLISHER:

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LET THE SUPPLIER BEWARE

BUSTOUTS BREAK THE BANK AND LEAVE NO TRAIL

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A bustout conjures images of someone escaping from jail under cover of darkness. But the word also denotes a methodical bankruptcy scam devised to part a trusting supplier from his or her inventory and revenue. The main characters in this economic disaster are an unsuspecting supplier, an exhausted credit line, a string of unpaid invoices and (ultimately) a disappearing customer.

A bustout leaves no paper trail, so catching perpetrators is difficult. How does it work exactly? Let's look at a typical bustout scenario to give you an idea of how this costly game is played.

The Bustout Hustle

A successful bustout always includes a trusting supplier. Suppose Nola Contendre starts a fake company, Edifice Wrecks Demolition, and sets up a temporary shop. Nola researches the local market and finds a nearby wrecking-ball company, Block Breakers Corp. she begins placing wrecking ball orders. Nola initially pays for her purchases in full, thus building trust between Edifice Wrecks and Block Breakers.

Because Block Breakers is so happy with Edifice's order volume, it offers generous credit terms. Edifice then increases its wrecking-ball purchases until it exhausts its credit line, while at the same time not paying Block Breakers any of the outstanding invoices. By the time Block Breakers becomes suspicious, Nola Contendre has dismantled Edifice Wrecks and disappeared. Block Breakers has been had and can forget about even collecting a nickel from Nola.

Ms. Contendre knows that the next bustout pigeon is just-as-easy pickings. It's the consumer willing to buy a product so far below market price it's clearly either stolen or a miracle. So Nola sets up a company called Stealer's Wheels Ltd. And sells the wrecking balls she stole from Block Breakers at a steep discount. Fortunately for her, some otherwise law-abiding purchasing agents don't have a problem buying a brand-new $5,000 wrecking-ball for $1,000. Because Nola never paid

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AS CREDIT DEPARTMENT GOES ELECTRONIC, CONSIDER E-MAIL POLICY

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The hazards of e-mail, both retaining them and not doing so, have made headlines. With Enron, on the one hand, a stored e-mail from in-house counsel raising concerns about accounting improprieties served as a roadmap for federal prosecutors. Several Wall Street investment banks, on the other hand, are facing multimillion dollar fines for not keeping e-mail messages. These recent headlines highlight the significance of e-mail communications and raise the question of the credit professional's e-mail retention program.

E-mail has revolutionized how the credit professional communicates with customers, the credit department and credit colleagues. Using e-mail, a customer, whether located across the city or across the globe, can provide the credit professional with hundreds of pages of confidential financial information to assist with credit analysis, immediately and inexpensively. The credit professional and customer can negotiate using e-mail over credit terms. Underscoring the explosion of e-mail use in commerce, businesses around the world are estimated to send over a trillion e-mail annually.

However, the ability to transfer and download confidential information carries with it some risks to the credit professional. Further, the credit professional must consider a policy of sharing and storing e-mails. A "deleted" e-mail does not necessarily mean it is expunged from the hard drive. Where a credit professional is provided a customer's confidential information through e-mail, what steps should the credit professional take to keep the e-mail confidential and out of a lawsuit?

E-Mail Communication and Litigation

Consider a common situation: a credit professional receives financial information for credit analysis purposes from a customer conditioned on signing a confidentiality agreement. The confidentiality agreement requires the credit professional to take reasonable steps to maintain the secrecy of the documents. The standard confidentiality agreement provides that the credit professional's company may be liable for damages if the confidential information is leaked. The customer's financials are transferred to the credit professional via e-mail. If th company inadvertently discloses the financial information electronically, the vendor may be sued by the customer.

A problem with e-mail from a litigation standpoint is that it creates a lasting record, unlike a phone call that is temporary. A vendor can be compelled to produce e-mailed material in litigation, unless otherwise privileged. If the credit professional's company has a uniform policy of e-mail expirations or shredding its e-mail unless it has some future value, the company embroiled in litigation may not be punished by a court if it does not turn over the information.

If the vendor is embroiled in litigation it may make sense to retain the e-mail to avoid a negative suggestion. However, archiving saved e-mails can be problematic when attempting to retrieve the stored e-mail. Is there a solution for the credit professional to avoid, or limit, this kind of risk when the confidential information is exchanged via e-mail?

New Technological Developments for Keeping E-Mail Communications Confidential and Out of a Lawsuit

Recent technological developments may provide greater protection for the credit professional from an errant confidential e-mail falling in the hands of a competitor, or otherwise keep the e-mail in-house. The starting point is that the credit professional deleting an e-mail does not mean it is lost from the server. Because of this, new e-mail software may send a message to self-destruct after passage of time, can limit the number of times a message is opened and read, tag messages so that they cannot be forwarded and label messages to prevent cutting, pasting or printing. The software expires both sent and received e-mail. This means that such e-mails are temporary, and from an evidentiary basis, may not fall in the hands of a competitor or used in a lawsuit.

New developments for e-mail may also allow for the credit professional to block the recipient from pasting, printing or forwarding, including the accidental forwarding, the e-mail message. In other words, the credit professional may encrypt a set of rules with its e-mail that blocks forwarding the e-mail -- a virtual e-mail paper

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WORKING THROUGH YOUR KEY CUSTOMER'S FINANCIAL DIFFICULTIES WHILE BETTERING YOUR POSITION FOR PAYMENT ON THE DELINQUENT ACCOUNT

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You are a sole-source supplier with a long term contract with a customer. The supply contract provides for 30 day credit terms. The customer accounts for a significant percentage of the vendor's sales, which are on credit. With the downturn in the economy, the customer loses business, resulting in significant cash flow problems. However, your research indicates that the customer's financial problems are temporary, and may remain a significant source of business over the long term. The customer has problems paying its lender, who has a security interest in all of the assets, as well as its vendors. Your account is past due.

You consider alternatives for repayment of the delinquent account, yet still have the customer remain a significant source of business. One alternative, the customer solicits your company to invest in it to continue to operate during the short-term downturn. Your company does not want to lose the significant revenue generated by the customer, but obviously does not want to increase its credit exposure.

Creditor instead of investor: to retain the significant source of business, the vendor may consider a short term loan to assist the customer's cash flow. Creditor status gives the vendor priority in the event the customer fails to repay, as opposed to investing in the customer.

Guarantying some of the customer's debt: the vendor may consider serving as a guarantor of certain of the customer's debts. The upside is that it may not require an immediate infusion of cash. However, the risk is that the vendor may have to pay on the guarantee if the customer fails to pay the guaranteed debts. The guarantee may calm creditors and allow the customer to continue to operate.

Working with the customer's

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two CPA's and three non-CPA's.

PUBLIC COMPANY'S DUTIES

SOA imposes a number of duties and restrictions on officers and management of publicly traded companies.

Attempting to Hold Officers Accountable

The CEO and CFO must sign a certification that the company's periodic reports do not contain untrue statements of a material fact. All financial information must accurately present the company's financial conditions and results of operations for the period.

Certifying officers must establish internal controls to ensure that employees provide material information regarding the company and its subsidiaries. Signing officers must also acknowledge that they have evaluated the company's internal financial controls within the 90 days before the filing of the report. The report must include conclusions of their evaluation. Certification must also state that the CEO and CFO have reported to the auditors and audit committee of the company all information regarding significant deficiencies in internal controls that could adversely affect the company's ability to provide an accurate report.

The CEO must sign the company's tax returns. An officer or director that knowingly makes a false certification may be fined up to $5 million and jailed for up to 20 years.

SOA also prohibits officers and directors from taking any action to fraudulently influence auditors.

SOA prohibits personal loans to officers and directors. A corporate insider must disclose stock sales of the company within two days. SOA requires that transactions involving management and principal stockholders must be disclosed to the public immediately.

Under SOA, if a company is required to make an accounting restatement due to material noncompliance with any of the reporting requirements, the CEO and the CFO must reimburse the company for any bonus or other incentive-based or equity-based compensation during the 12 month period following first public issuance or filing with the SEC and any profits realized from the sale of securities of the company during that 12-month period.

Reporting "Material" Information

SOA attempts to address the recent "failure to disclose" raised in the Enron debacle by requiring public companies to disclose material off-balance sheet transactions, as well as immediately present material adjustments to financial statements.

Current Financial Disclosure

A company is required to immediately disclose information about its financial condition or operations that is necessary or useful to investors.

An Independent Board of Directors

SOA states that each member of the company's audit committee shall be a member of the board of directors and shall be independent. The SEC has recently shown its aggressiveness in pursuing officers of corporations where there is alleged corporate fraud.

Avoiding Conflicts

Part of the focus of SOA is to eliminate overly close ties a company may have with its auditors. Enron is an example where its auditor, Arthur Andersen, had former employees in influential positions within Enron. With SOA, the company's officers cannot have been employed by its audit firm and worked on the audit of the company within a year preceding the audit.

Audit Committee

The public company must have an audit committee. The company's auditor should report to the committee regarding accounting policies to be used, and the audit committee has the power to hire and fire the auditor.

Whistleblower Protection

SOA provides whistle-blower protection to those who assist investigations being conducted by a federal regulatory or law enforcement agency.

Civil Liability: Securities Fraud Claims Expanded

SOA expands the time to commence private securities fraud claims from two years from discovery or five years from violation.

White Collar Crime Enhancements

The crime of financial fraud is added and the statute of limitations to bring such action is five. Mail and wire fraud penalties are increased to 20 years.

AUDITOR'S DUTIES

SOA imposes a number of duties and restrictions on the auditors of publicly traded companies, including federal government oversight through an accounting board, independence rules and disclosure requirements.

An Auditor's "Questioning Mind"

SOA imposes on the auditor that it reviews its clients' financial statements with a critical eye and independence. Public auditors must maintain audit work papers for a minimum of seven years, provide for a concurring or second-partner review of each audit report, and describe in each audit report the scope of the auditor's testing of the internal control structure and procedures of the company.

Partners in charge of conducting a company's audit must be rotated every five years. Accounting firms may not perform audits for a company if the company's CEO, controller, chief accounting officer, or any person of such standing was employed by the accounting firm within one year of the audit.

Splitting the Business

OSA prohibits accounting firms from offering "non-audit" services to companies for whom they perform audits. Non-audit services include bookkeeping or other services related to accounting and financial statements, financial information systems design and implementation, appraisal or valuation services, fairness opinions or contribution-in-kind reports, actuarial services, internal audit outsourcing services, management functions or human resources, broker, dealer, investment adviser or investment banking services, legal services and expert

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that receives a greater payment than similarly situated unsecured creditors disgorge the payment so that like creditors receive an equal distribution of the debtor's assets.

Not all transfers made within the preference period are avoidable. To protect those transactions which replace value to the bankruptcy estate previously transferred, the Bankruptcy Code carves out seven exceptions or defenses to the trustee's recovery powers. The most commonly asserted exception by vendors is the ordinary course of business defense.

That defense protects payments, in all or part, received by an unsecured creditor within 90 days of the bankruptcy from recovery where the creditor establishes certain elements detailed below. The policy supporting the ordinary course of business defense is two-fold: (1) protect customary transactions, and (2) encourage creditors to continue to extend credit to financially troubled debtors, possibly helping the debtor avoid bankruptcy.

To qualify for the ordinary course of business defense, a creditor must establish that the payment is ordinary as between the parties and that the payment is ordinary in relation to prevailing business standards. The court determines a debtor's ordinariness of payments through comparison with prevailing business standards, which includes common terms used by other trade creditors in the same industry facing similar problems. Thus, only transactions between the parties so unusual as to fall outside the broad range of industry practice should be considered non-ordinary under this preference defense.

To establish the ordinary course of business defense, the vendor must not only establish the payments received from the customer during the preference were ordinary with payments prior to the preference period, the vendor may be required to show that the customer's practices are similar, though not necessarily identical, to oth-

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services unrelated to the audit, and any other services determined by board to be impermissible.

If a company wishes to employ their public accounting firm to perform non-audit functions not described above, the audit committee of the company must give the company advance approval.

Disclosure of Off-Balance Sheet Transactions

Enron's notoriety surfaced with belated disclosure of billions of dollars in off-balance sheet liabilities. SOA addresses this by requiring auditors to disclose a company's material off-balance sheet transactions.

Pro Forma Financials

Pro forma financial information shall be presented in a manner that does not contain an untrue statement of a material fact or omit to state a material fact necessary to make the financial statements not misleading and follow generally accepted accounting principals.

Criminal Penalties

An accountant's failure to maintain all work papers for five years may be punishable by a fine and jail of up to 10 years. An accountant that willfully impedes a federal investigation or bankruptcy may be punished by a fine or jail up to 10 years.

Conclusion

Earlier we raised the following questions:

- How will the law affect credit professionals and their publicly traded customers? In our opinion, the OSA attempts to force publicly traded companies to report their financial information more responsibly, emphasizing full disclosure.

- Will the law change the way corporate officers, accountants and lawyers deal with financial disclosures? There are significant penalties for those corporations and their accounting professionals who choose not to adequately disclose.

- Will financial information reported by public companies become more reliable, thereby reducing credit risk for vendors selling on open account? We believe that the current environment has brought to the limelight the abuses of select corporate officers. The focus is now on curbing abuse and making financial statements more reliable for the benefit of all those who rely on them.

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CONSIDER E-MAIL POLICY

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shredder.

Encryption is used to keep online communications like e-mail private. This would allow that a confidential e-mail communication not fall in the hands of a competitor. The recipient unlocks the e-mail with a key and is bound by the credit professional's terms. Another development is e-mail that is automatically erased after 24 hours after being opened, the equivalent of disappearing ink. Of course, for the credit professional looking to retain a customer's confidential information disappearing e-mail does to work.

The benefits to the credit professional for using encrypted e-mail is that confidential information, be it communications with a customer over credit terms or financial information provided by the customer, will not end up in a lawsuit or open up the door for the credit professional's company from being sued for breaching a confidentiality agreement.

UNDERSTANDING THE ORDINARY COURSE OF BUSINESS FOR THE BANKRUPTCY PREFERENCE LAWS: WHAT IS THE INDUSTRY STANDARD?

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ers in the industry.

The *Gulf City* court wrestled with how to define the industry from which to compare the industry standard, but ruled:

> [F]or an industry standard to be useful as a rough benchmark, the creditor should provide evidence of credit arrangements of other debtors and creditors in a similar market, preferably both geographic and product.
> . . . In this case, [the vendor] might provide evidence, to the extent that it is reasonably available, of credit practices between suppliers to whom [debtor] might reasonably turn for its searfood supply and firms with whom [debtor] competes for consumers, from which a bankruptcy judge can determine whether there is some basis to find that the [vendor-debtor] arrangement is not a virtual stranger in the industry.

The *Gulf City* court considered a case involving a pizza parlor. Is the appropriate industry sellers of sausages to all businesses, just pizza parlors, or suppliers of all pizza supplies? The court reasoned that a vendor has the burden to show the trade practices between suppliers to whom a debtor might reasonably turn for its product for supply, and firms with whom the debtor competes for customers.

This evidence was missing from a vendor's defense in *Gulf City*, so the case was reversed and remanded to the bankruptcy court.

ESCHEATMENT

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unclaimed property during the dormancy period. In order to deduct charges, the holder must have a valid written contract with the owner, regularly impose the charge, and the amount of the deduction may not be unconscionable.

Annual Reporting

The holder of unclaimed property must submit an annual report to the state in which the property escheats. Some states require "negative filing," which is a report demonstrating that the holder is not in possession of unclaimed property. The holder should file an annual report using forms that are provided by the individual states.

Generally, the annual report requires the following information. First, the report should provide a brief description of the unclaimed property, including dates that the property became payable and the last transaction with the owner. Second, the report should provide the owner's name, address, and social security number or tax identification number. Third, if permitted by state law, a report should aggregate all claims with minimal value. A holder should consult state law to assure compliance with state-specific procedures.

In addition, a majority of states require a final notice period. Generally, the holder of unclaimed property is required to provide notice to the owner that the property is subject to escheatment. This notice is required 60 days to 120 days prior to escheatment if the unclaimed property meets minimum value threshold requirements.

Challenging Abandoned Property Laws

In an effort to avoid turning over property to the state, some businesses include contractual provisions that cause the loss of the owner's property rights prior to the time the property would escheat. For example, a business may include a statement on a written instrument declaring that the owner's failure to negotiate an instrument within a certain period of time constitutes private escheat (i.e., the property reverts back to the holder). A majority of courts conclude that this practice circumvents public policy and constitutes an attempt to avoid compliance with unclaimed property laws.

In addition, some businesses argue that credit balances and credit memos resulting from business to business transactions should not be subject to escheatment for the following reasons. First, business transactions are not similar to consumer transactions since businesses have the capability to audit accounts and an incentive to collect outstanding balances. Second, unclaimed property arising from business transactions is usually the result of administrative errors or a credit issued against future purchases to preserve goodwill. Third, compliance results in an administrative burden that exceeds any benefits to society. Although certain states have excluded this property from reporting requirements, the majority of states require reporting business to business transactions.

Compliance

Generally, compliance with a state's unclaimed property law is mandatory. There are significant civil penalties for the failure to comply with reporting requirements. Penalties range from simple interest to the full value of the unclaimed property. In addition, some states impose daily penalties. Moreover, if a business willfully or fraudulently files a report, then the penalties may exceed $1,000 per day. However, criminal penalties are rare.

Conclusion

Compliance is an ongoing process that requires conscious efforts to implement procedures to comply with state law. The states have several methods to enforce unclaimed property laws. These methods include auditing the business for compliance and voluntary amnesty programs to entice businesses to comply without incurring penalties. It is necessary for businesses to comply with state escheatment laws and file annual reports to avoid the consequences of time consuming audits, monetary fines, and the surprise associated with remitting thousands, even millions of dollars, in unclaimed property that has accumulated over the years.

BUSTOUTS BREAK THE BANK AND LEAVE NO TRAIL

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for them, her wrecking-ball proceed are pure profit. And consumers willing to buy stolen goods at a steep markdown are complicit in the bustout scam.

Forsight can be 20/20

As you might expect, companies that perpetrate bustouts are unlikely to be members of the local Chamber of Commerce. The best defense against a potential bustout is sticking to basic credit management principles:

1. Require a prospective customer to fill out a complete disclosure form. This should include banking, credit and character references.
2. Be vigilant in checking references. Verify any information prospective customers provide by reviewing Dun & Bradstreet reports and calling trade and credit references.
3. If a prospective customer appears suspect, inquire further. The Better Business Bureau as well as local and state law enforcement agencies can facilitate the inquiry. If necessary or advisable, hire a certified fraud examiner to assist you in conducting your new-customer due diligence.

A Customer Disclosure Form Says a Lot

Another defense measure is to have potential buyers fill out a disclosure form. The answers may be monosyllabic, but the amount you save can be several digits long. Among the questions to ask are:

- How long has your business existed?
- How long has your business operated in this area?
- Does your business have a history of moving from location to location?
- Does your business maintain any ties to the community, such as memberships in local organizations?
- Where does your business maintain its bank accounts?
- Where does your business maintain its office?
- Is the office a street address or a post office box number?
- Who is the principal owner, and will he or she provide a personal financial statement?
- Will the principal owner personally guarantee the business obligation?

No legitimate businessperson will hesitate to answer these questions. Alarm bells should go off if a prospect wavers. Also, when possible, drive by a prospective customer's offices. Does business appear to be conducted there or is it an empy storefront?

Don't Become a Fraud Statistic

Under U.S. law, an accused perpetrator is considered innocent until proven guilty. In business practice, every customer should be considered capable of fraud until proven trustworthy. If a prospective customer is forthcoming in handing over references, then perhaps you can safely do business with that company. But if the response is less than open, avoid it. Please call us if you need assistance in protecting yourself against bustouts or about any other fraud-related matter. We would be glad to help you avoid victimization. Businesses defrauded by companies that leave behind empty offices, disconnected phones and no recoverable assets usually fail to get bankruptcy court relief.

You Can Trust the Bureau

As mentioned about, a stalwart defense against many fraud schemes remains the Better Business Bureau (BBB). Founded in 1912, its system helps nearly 24 million businesses and consumers yearly and covers more than 98% of the nation, including Alaska, Hawaii and Puerto Rico. The BBB believes that people can equitably solve most marketplace problems by using education and self-regulation. Its Web site – www.betterbusinessbureau.com – provides, among other services, consumer and business education, dispute resolution, business reliability reports, charity review and truth-in-advertising information.

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WORKING THROUGH YOUR KEY CUSTOMER'S FINANCIAL

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lender: the customer's lender has a security interest in all of the customer's assets including accounts receivable, inventory and cash. The vendor may be able to calm the lender's anxiety with the customer's financial performance by committing to guarantee certain of the customer's accounts receivable, or guarantee a floor for the lender's collateral should it be forced to foreclose on the customer.

Personal and affiliate guarantees to protect the vendor: the vendor may insist that the owner of the customer (if it is a closely held company) provide a personal guarantee to the vendor to protect it for its financing. The guaranty creates a contract of secondary liability. The owner may provide the guarantee to the vendor given the alternative that the customer's lender may foreclose on the business. Likewise, the customer may have an affiliate business with value that may furnish a guarantee to the vendor.

Purchasing the customer: in certain situations, the vendor may determine that the economics are such that buying the customer may be the most effective way to maximize the value of the relationship. This is the ultimate equity investment.

The vendor has to be careful with its approach to financially assist the customer. The vendor cannot misstep with its strategy to reduce its credit exposure but open the door as a target for litigation from other creditors, including its lender.

RECENT ENGAGEMENTS AND ACTIVITIES

Blakeley & Blakeley LLP Recent Engagements and Activities for Spring 2002

Blakeley & Blakeley continues to represent its vendor clients in the areas of creditor rights, commercial litigation and collection, preference defenses, credit documentation, bankruptcy and out-of-court workouts.

◊ Scott Blakeley spoke to the **National Distribution Group** in **Phoenix** regarding **Escheatment and Creditors' Rights.**

◊ Scott spoke to **National Group Management's Food Manufacturer's Credit Group** in Las Vegas regarding **Deductions and Offsets.**

◊ Scott spoke to **NACM/Chicago-Midwest's National Paper and Packaging Group** in San Francisco regarding **The Internet, E-Credit, and Legal Developments.**

◊ Scott spoke to the **NACM Housewares Group** in Las Vegas regarding **From Enron to Worldcom: Recent Developments with Financial Reporting.**

◊ Scott spoke to **NACM/South Texas' National Lawn and Garden Group** in Philadelphia regarding **Accepting Credit Card Payments on Commercial Accounts: the Risks and Opportunities.**

◊ Scott spoke to **Reimer Reporting's National Footwear Credit Group** in Las Vegas regarding **Recent Developments with Article 9**.

◊ Scott spoke to **NACM/Chicago-Midwest's Homecenter's Group** in San Francisco regarding the **Sarbanes-Oxley Act.**

◊ Scott spoke to **Rohm & Haas** in Philadelphia regarding **Bankruptcy and Creditors' Rights**.

◊ Scott spoke to **NACM/Mid-Atlantic** members in Baltimore regarding **Accepting Credit Card Payments on Commercial Accounts: the Risks and Opportunities.**

◊ Scott spoke to **NACM/North Central's International Fitness Credit Group** regarding **The Internet, E-Credit, and Legal Developments.**

◊ Scott spoke to the **Orange County Credit Professionals** regarding **Bankruptcy and Creditors' Rights.**

◊ Scott spoke at **NACM's Annual Loss Prevention Business Credit Fraud Symposium** on **The Risks of Bustouts in the Aftermath of Sept. 11.**

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