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

KEEPING THE CREDIT PROFESSIONAL'S E-MAIL COMMUNICATIONS CONFIDENTIAL AND OUT OF A LAWSUIT: SELF-DESTRUCTING E-MAIL

Scott Blakeley

E-mail is revolutionizing how credit professionals communicate with customers. Credit professionals are using the Internet for a myriad of credit and financial functions, from credit research and scoring, to automatic invoicing customers through their Web site, to automatic payment posting. Customers can provide credit professionals with confidential financial information to assist the credit professional with the credit analysis through e-mail, at a very inexpensive cost whether across the street or across the continent. The credit professional and customer can negotiate online over credit terms. Underscoring the explosion of e-mail use in business, businesses around the world are estimated to send over a trillion e-mail this year. However, the ability to transfer and download confidential information carries with it some risks to the credit professional. Where a credit professional has been provided a customer's confidential information through e-mail, what steps should the credit professional take to keep e-mail communication confidential and out of a lawsuit?

E-Mail Communications and Litigation

On occasion, a credit professional will receive financial information from a customer where the credit professional must sign a confidentiality agreement and agree to keep the information confidential. The credit professional must 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.

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 will likely not be punished by a court if it does not turnover the information. However, if the vendor is embroiled in litigation it may make sense to retain the e-mail to avoid a negative suggestion. How does the credit professional 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. New e-mail systems can tell messages to self-destruct after a certain amount 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. This means that such e-mails are temporary, and from an evidentiary basis, will 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 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.

CONTENTS

ESCHEATMENT: A PROBLEM FOR THE CREDIT EXECUTIVE?

Mary Ludwig Schaeffer [1]

Scott Blakeley

The *Wall Street Journal* recently reported that Bankers Trust was fined $50 million for failing to escheat. A credit professional often manages a portfolio of hundreds of open accounts, with credit extensions that can be in the millions of dollars. On occasion with an active trade relationship, for the vendor the account may periodically have a surplus**.** On occasion the debtor never claims the surplus. Are escheatment laws, or as commonly referred unclaimed property, a problem for the credit executive? What is considered unclaimed property that may fall under the escheat laws? Does a credit balance qualify? What may be the consequence if the vendor declares the unclaimed property as income and applies it to the bottom line, as the vendor views it as a windfall to offset losses from unrelated delinquent accounts? Does the state have greater rights to the unclaimed property?

A. Escheatment Defined

Businesses and residents abandon over a billion dollars of tangible and intangible property annually. Every state has legislation that requires individuals and companies to escheat, or abandon property, to the state after some period. California, for example, requires escheatment to the state after three years of abandonment. Escheatment includes all forms of property, both tangible and intangible. Escheatment laws provide that the state becomes the legal owner of abandoned property, based on the concept of state sovereignty.

B. Development of Escheatment Law

The origin of escheatment law dates back to British law. Abandoned land was returned to the king. The states within the United States have followed this principle.

1. Uniform Disposition of Unclaimed Property Act

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

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

In the case of real property, this is not difficult. However, because the states' escheat statutes also apply to intangible abandoned property, a state must establish that it has sufficient contacts with intangible property before escheat. Generally, if the property is considered to have a situs within the state, it is subject to escheat. The Uniform Act establishes a period for a presumption of abandonment for most types of property. For example, in California if the property is unclaimed for three years after it becomes payable or dispersible, the escheat laws apply. Presently, forty-two states (including California, New York, Texas, and Florida) and the District of Columbia have enacted some version of the Uniform Act.

C. Risks of Not Escheating

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

D. The Bankers Trust Investigation

Bankers Trust pleaded guilty to three felony counts and agreed to a $60 million fine in connection with failing to escheat unclaimed funds and diverting the funds to the bank. Three former employees of the bank were charged with criminally conspiracy, misapplication of funds and false record keeping. According to the indictment, the three employees, under pressure to improve financial performance, diverted unclaimed funds for the purpose of meeting revenue and expense targets.

E. States Adopting Amnesty Program

If your company is not escheating, what can be done? 37 states have recently

(continued on page 8)

FROM THE PUBLISHER:

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If you have a hot topic affecting the credit and financial professional, e-mail this to Scott.

SERVING (AND SURVIVING) ON A CREDITORS' COMMITTEE: YOUR FIDUCIARY RESPONSIBILITIES

Scott Blakeley

Your problem account which you extended an unsecured credit line of six figures has filed chapter 11 bankruptcy (the reorganization chapter of the Bankruptcy Code). You had vigorously attempted to collect the delinquent account, appreciating your salesperson's constant comment that the account would pay. However, with the bankruptcy filing your individual effort to collect the unsecured delinquent account shifts from individual effort to collective effort with other vendors holding the largest unsecured claims.

You are scheduled by the debtor as holding one of the 20 largest unsecured claims. You receive a Creditors' Committee Solicitation Form from the Office of the United States Trustee (OUST) inviting your company to serve on the official committee of unsecured creditors. You complete the form return it to the OUST. The OUST appoints your company to serve on the creditors' committee, and you are designated to serve as the company's representative. What are your duties and responsibilities in serving on a creditors' committee. A recent bankruptcy decision, *In re J.F.D. Enterprises, Inc.*,[1] underscores a creditors' committee and its members fiduciary duties is limited to the class of creditors it represents -- unsecured creditors.

Membership on the creditors' committee often involves months of negotiations with a Chapter 11 debtor regarding payment plans for creditors, as well as other issues involving the operations of the business. A favored threat of debtor's counsel in heated negotiations with a debtor, especially if the creditors' committee resolves to oust the debtor's management control and impose an impartial person, a Chapter 11 trustee, is that the creditors' committee, or a member (especially the most vocal committee member seeking a trustee, has breached fiduciary duties. What is a breach of a committee's breach of fiduciary duties? When has a court found a committee member has breached its fiduciary duties? More plainly, what is the upside and downside with serving on a creditors' committee.

Appointment Of Creditors' Committee

Upon the filing of a bankruptcy petition, payments to unsecured creditors are suspended and vendors are entitled to assert claims for the unpaid value of their goods and services against the debtor. The typical chapter 11 bankruptcy often has hundreds, even thousands, of unsecured vendors, many of whom hold claims of modest amounts. A creditors' committee is intended to deal with the debtor in a more manageable fashion than the entire body of unsecured creditors could, permitting them to speak in one voice and assuring representation of creditors who would otherwise be unable to effectively participate in the bankruptcy because of economic constraints.

The formation of a creditors' committee aids the debtor and the bankruptcy court as it provides for a centralized body vendors to be heard and dealt with. The creditors' committee's chief responsibilities are to act as liaison and watchdog between the debtor and its constituency, the unsecured creditors of the estate, and to ensure a fair settlement of the debtor's financial difficulties in compliance with the Bankruptcy Code.

The OUST has the exclusive responsibility to select a creditors' committee in chapter 11 (a creditors' committee is not appointed in a chapter 7 liquidation, as a general rule). The OUST is also has authority to remove members from the committee. The OUST is an adjunct of the Justice Department, and is a national program. The members are chosen from a list of the 20 largest unsecured creditors prepared by the debtor. Often, the OUST will convene an "early meeting", or conference of creditors for the 20 largest unsecured creditors, within two weeks of the debtor's bankruptcy filing. The OUST will then appoint five to nine representatives (an odd number avoids tie votes) to serve on the creditors'

(continued on page 5)

DEALING WITH THE INSOLVENT CUSTOMER: VENDORS MAY COLLECT TRANSFERS AS FRAUDULENT THAT CORPORATE DEBTOR'S SOLE SHAREHOLDER MADE TO HIMSELF

Scott Blakeley

Vendors of an insolvent corporate debtor hunting for assets to pay their delinquent accounts may look to the state and federal fraudulent transfer laws to aid in recovering assets that have been transferred. How do the fraudulent transfer laws work, and in what instances may vendors use these law to recover property transfers? The court in *Gaddis v. Allison*[1] considered whether transfers from a corporate debtor to sole shareholder were fraudulent transfers.

Corporate Debtor Pays Bonuses to Sole Shareholder

In *Gaddis v. Allison*, the corporate debtor operated a chain of stores. The debtor's principal was the sole shareholder, officer and director. As an employee, the debtor's principal earned an annual salary of $75,000 and a $25,000 bonus. The debtor suffered financial hardship and was unable to pay debts when due. The debtor was forced to liquidate its assets. During the liquidation, the principal transferred cash and assets valued at $665,000 from the corporation. The principal did not perform any extraordinary services to justify these payments. There was no minutes from the board of directors to authorize the payments. The corporation's unsecured creditors were not paid. Three vendors filed an involuntary bankruptcy petition. The bankruptcy trustee sued the principal to recover the $665,000 payments. The principal claimed that the transfers constituted salary under the liquidation of the assets. The bankruptcy ruled in favor of the trustee and ordered the principal to disgorge the

(continued on page 6)

UCC SEARCHES IN THE COMPUTER AGE: A HYPHEN MAY MAKE A DIFFERENCE

Scott Blakeley

The introduction of computer technology is revolutionizing the credit field. Access to seemingly limitless information and reporting is now available on a credit executive's desktop. One example of how a credit executive may use computer databases is in a lien search. A lien search may provide important information to a credit executive evaluating whether to extend credit and the amount of a credit line, as the search discloses the number and type of secured creditors the debtor has. This information may be used by the credit executive for cash flow and liquidation analysis of the debtor and may provide a compelling picture of the risk of extending credit.

While computers reduce the time to conduct a lien search, their efficiency may also create certain risks for the credit executive. Uncovering a lien has everything to do with how that lien was recorded with the recording office, usually the Secretary of State. A computerized database search of the debtor's name will not uncover liens that have been improperly recorded. Here's why: if a creditor who has filed a lien failed to properly record the debtor's name, the lien will not show up in a database search by the debtor's correct name to the exact input it is given. This is not such a widespread problem in manual searches because the person doing the manual search also checks for basic variations of the debtor's name.

In *ITT Commercial Finance Corp. v. Bank of the West* [1], the creditor failed to file its financing statement using the debtor's exact legal name. A computerized database search had not uncovered the lien, yet the lien was uncovered in a manual search. The court had to consider whether the lien should stand. Under Article 9 of the Uniform Commercial Code, courts generally allow liens to stand where the secured creditor's mistake in recording the debtor's name is not seriously misleading to anyone conducting a search. However, the *ITT Commercial* court found that the debtor's misspelled name was seriously misleading as it was not discovered in a computerized search and the lien should be unseated.

Competing Creditors' Claims

In *ITT Commercial*, a lender provided financing to a debtor secured by all of the Debtor's assets (the First Lender). The debtor's name was "Compu-Centro, USA, Inc.". The First Lender filed its financing statement specifying the debtor as "Compucentro, USA, Inc." The financing statement left out the hyphen in the corporation's legal name.

Thereafter, a lender provided inventory financing to Compu-Centro, USA, Inc (the Second Lender). The Second Lender filed a financing statement covering the debtor's inventory. The Second Lender obtained an official lien search of the Secretary of State's records in the "Compu-Centro, USA, Inc." The First Lender's financing statement filing was not listed on the search report. There was a shortfall from the debtor's sale of assets, and the Second Lender went unpaid. The Second Lender sued the First Lender contending that its lien should be unseated because the First Lender failed to record the debtor's exact legal name, allowing the Second Lender to take priority. The Second Lender contended that the First Lender had not properly perfected its lien because it failed to include a hyphen between the corporate debtor's name in its financing statement. As noted, a computer search by the Second Lender under the name "Compu-Centro, USA, Inc." did not reveal any lien in favor of the First Lender.

Lien Searches In The Computer Age

Perfecting a security interest in personal property is a multi-step procedure under Article 9 of the Uniform Commercial Code (UCC). When the debtor obtains secured financing, the debtor first executes a security agreement describing the collateral, which gives the creditor a security interest in the collateral. The creditor perfects the security interest when it files a financing statement with the filing office (usually the Secretary of State and, perhaps, the County Clerk) which adequately describes the collateral.

Section 9-402 of the UCC provides that a financing statement must include the names of the debtor and the secured party. But section 9-402 also provides "[a] financing statement substantially complying with the requirements of this section is effective even though it contains minor errors which are not seriously misleading." The *ITT Commercial* court framed the issue as whether leaving the hyphen out of the debtor's name was seriously misleading to the searcher. If it was found to be seriously misleading, it would render the creditor's lien avoidable.

As a general rule courts treat mistakes involving a descriptive word as minor and not seriously misleading. A financing statement is not seriously misleading if a prudent subsequent creditor would have discovered the prior security interest. While the UCC does not require exactitude, there can be less tolerance of errors in a debtor's name, since such errors may prevent a searcher from discovering the financing statement. However, financing statements that are not likely to be located by reasonably prudent subsequent creditors because of misspellings, such financing statements cannot provide effective notice to subsequent creditors, undermining the purpose of the UCC filing system. Reasonably prudent subsequent creditors are not required to search under every conceivable misspelling of a debtor's name.

A Brief History of Lien Searches

The *ITT Commercial* court reviewed the history of lien searches, noting that prior to the arrival of computers, a debtor's name was indexed alphabetically with the filing office, usually the Secretary of State, listing all of the financing statements, or UCC-1's, filed. A manual search in response to a request from a credit executive considering extending credit required an employee of the Secretary of State to look manually through the index book, similar to someone searching through a telephone book. A benefit of manual searching is that the searcher can retrieve and list not only those financing statements that exactly match the requested debtor's name but also

(continued on page 7)

SERVING (AND SURVIVING) ON A CREDITORS' COMMITTEE: YOUR FIDUCIARY RESPONSIBILITIES (Continued)

(continued from page 3)

committee. The appointment process can be controversial, especially in larger Chapter 11 cases, where the debtor has a mix of creditors from bondholders, financial institutions and trade creditors. For example, does the OUST appoint a separate bondholders committee when the debtor has bond debt?

The Bankruptcy Code permits the creditors' committee to employ counsel and other professionals to represents its interests. For example, accountants are often needed to evaluate the feasibility of a plan of reorganization, would a liquidation be of maximum benefit and whether the debtor is operating at a profit. The professionals are compensated by the bankruptcy estate. A professional's fees and costs are paid in full prior to the unsecured creditors being paid. To encourage creditors to serve on the creditors' committee, members can be reimbursed, as a first-priority claim, all reasonable expenses incurred in attending to committee duties.

The Creditors' Committee In Action

The debtor operated a retail store. The debtor ran into financial problems and filed Chapter 11. After the business continued to lose money, a Chapter 11 trustee was appointed.

The trustee proposed to sell all of its assets. The creditors' committee opposed the sale, complaining that unsecured creditors would not receive a distribution if the sale were approved. The court refused to approve the sale. The case was converted to Chapter 7. The shareholders of the debtor sued the creditors' committee's attorney contending that the committee's blocking the sale resulted in a deficiency for the bank who held a personal guaranty of the shareholder. The court rejected the claim, noting that the creditors' committee owes a fiduciary duty only to the class of creditors it represents, the unsecured creditors -- not shareholders, secured creditors nor administrative creditors.

Fiduciary Duty Is To Class Of Unsecured Creditors

Members of the creditors' committee owe a duty of trust, responsibility and undivided loyalty to unsecured creditors. Consequently, whenever a creditors' committee votes on a issue, the individual members have a strict duty to vote with the overall interests of the unsecured creditors in mind. As noted, the *J.F.D. Enterprises* court ruled that a creditors' committee and its members owe no fiduciary duty to the debtor or other classes of creditors, such as a secured creditor or administrative creditor; the duty runs only to the creditors they represent. A committee member who violates fiduciary duties may be removed from committee, and possibly face personal liability.

What red flags may a credit professional look for that may signal an activity may violate their fiduciary responsibilities? While advising what activity may constitute a breach of fiduciary duty may be difficult, courts that have found a committee member has breached their fiduciary is where a committee has acted in its own self-interest to the detriment of unsecured creditors. This self-interest can occur in many forms, for example, from taking advantage of confidential information provided by the debtor where the committee member is a competitor of the debtor, to where the committee member is an undersecured creditor and looks to protect its interest in the collateral to the detriment of unsecured creditors.

Qualified Immunity of Committee Member

Members of a committee have limited immunity in carrying out their duties and powers, but such immunity does not extend to willful misconduct of the committee or its members. The only express grant of immunity to a committee and its members from liability concerns violations of securities laws where a party in "good faith" solicits acceptance or rejection of a plan. Where a committee fails to exercise its duties carefully or a committee makes false or inaccurate statements intending to injure the debtor, members may be subject to suits from the debtor or creditors.

Vendors Working Together To Maximize Payment

Membership on the creditors' committee does confer several key benefits to the credit professional including: access to financial and other information of the debtor; greater contact with the debtor; input and the right to vote on the position the committee takes; input on the debtor's business reorientation; and input in the formulation of the plan of reorganization. In other words, membership provides a vendor greater control over the amount and method of payment of its pre-petition claim and greater control over the direction of the debtor's business.

The *JFD Enterprises* decision reminds vendors that serving on a creditors' committee means the creditors' committee and its members look to the best interests of its constituents, the unsecured creditors. And committee members must avoid any selfish interest which may prevent them from fulfilling this duty of loyalty to maximize the value of its class.

1. In re J.F.D. Enterprises, Inc., 223 B.R. 610 (D. Mass 1998).

DEALING WITH THE INSOLVENT CUSTOMER: VENDORS MAY COLLECT TRANSFERS AS FRAUDULENT THAT CORPORATE DEBTOR'S SOLE SHAREHOLDER MADE TO HIMSELF (Continued)

(continued from page 3)

$655,000 for the benefit of unsecured creditors. The principal appealed.

Elements Of A Fraudulent Transfer

A debtor, whether individual, corporation, LLC or partnership, with sinister intent may devise an intricate scheme to channel assets away from creditors. Under state and federal law, these types of transfers are referred to as intentional fraudulent transfers.

In other instances, a debtor, without such sinister intent, has to unload its property to raise badly need funds. However, in such cases the debtor does not receive reasonably equivalent value for the transfer. Under state and federal law, these types of transfers are considered constructively fraudulent transfers. The power to avoid the intentional and constructively fraudulent transfers goes a long way toward protecting creditors from detrimental transactions.

Whether a transfer may be deemed fraudulent requires considering several factors, including the fraudulent intention of the parties, the financial condition of the debtor, the relative value exchanged, and the relationship of the debtor and the recipient of the transfer.

As noted, there are two general types of fraudulent transfers: the intentional fraudulent transfer and the constructive fraudulent transfer. The intentional fraudulent transfer is made with the actual intent to hinder, delay or defraud creditors. These derive directly from the Statute of Elizabeth from the Sixteenth Century. Certain "badges of fraud" have been employed by courts for centuries if such transfers are made with the intent to hinder, delay or defraud creditors: the transfer is to an insider; the debtor retained possession or control of the property transferred; the transfer or obligation was concealed; before the transfer, the debtor was sued or threatened with suit; the transfer was of substantially all of the debtor's assets; the consideration received by the debtor was not of fair value; the debtor was insolvent or became insolvent.

The constructively fraudulent transfer is made without actual intent by the debtor to hinder delay or defraud, but the transfer is deemed unfair to creditors where the debtor transfers assets for less than reasonably equivalent value while it was in financial distress (such as insolvency at the time of transfer, had unreasonably small capital as a result of the transfer, or incurred debts beyond its ability to repay by virtue of the transfer). The policy supporting the constructive fraudulent transfer is that a debtor may transfer assets for any value while it is financially healthy and paying its creditors. Where the debtor is in financial distress and creditors will not be paid in full, may the transfer be attacked as constructively fraudulent as the transfer did not yield fair value for the asset.

A trustee, debtor, or possibly creditors' committee, in bankruptcy has two different mechanisms for avoiding fraudulent transfers. The Section 548 of the Bankruptcy Code permits a trustee to avoid the types of fraudulent transfers specified therein. Section 544 of the Bankruptcy Code gives a trustee whatever avoiding powers an existing unsecured creditor might have under applicable non-bankruptcy law, e.g., the Uniform Fraudulent Conveyance Act or the Uniform Fraudulent Transfer Act, state laws prohibiting insolvent debtors from transferring assets. Under Section 548, a trustee may attack a transfer made within a year of the bankruptcy filing. Under Section 544, there is generally a longer reach back period.

Transfers Are Fraudulent And Recaptured For Unsecured Creditors

The *Gaddis* court evaluated certain factors in determining whether the $655,000 in transfers to the principal constituted fraudulent transfers: a close relationship existed between the debtor corporation and the principal, as the principal was the debtor's sole shareholder, officer and director; the debtor was insolvent at the time of the transfers, which the principal knew; there was no consideration for the transfers to the principal; and the transfers were contrary to normal business procedure. The court observed that the principal "knew at the time he was making transfers to himself that [debtor's] assets were rapidly diminishing, leaving no funds to pay the creditors." [2] The court observed the special relationship between a debtor corporation and its controlling shareholder or officers must be reviewed closely:

"[C]orporate directors enjoy privileged access to the company's financial accounts and inside information, a situation ripe for abuse. Corporation-director transfers are analogous to intra familial transfers: the relationship of the parties encourages collusion and concealment. . . Under the trust fund doctrine the assets of a dissolved corporation are a trust against which the corporate creditors have a claim superior to that of the stockholders, and creditors have the right to follow such assets into the hands of stockholders who hold assets as though the stockholders were trustees." [3]

The court found that the corporate debtor owed its unsecured creditors in excess of $1 million at the time the principal received the transfers. If the principal had not transferred the $6555,000 to himself, unsecured creditors could have been paid a significant portion of their debt. The transfers were a fraudulent transaction and could be recovered for unsecured creditors.

A Reminder to Vendors: Hunting for Assets

The *Gaddis* court shows that vendors may have an opportunity to recover assets with an insolvent debtor. What is a vendor's game plan to determine whether assets may be recovered with a bankrupt debtor? The first step in the vendor's investigation in dealing with a bankrupt debtor may be to review the debtor's bankruptcy schedules and statement of financial affairs. This financial information is filed by the debtor within the first 15 days of the bankruptcy filing, whether in a Chapter 7, Chapter 11, or Chapter 13, unless the court grants an extension of time. The credit professional, or an accountant for the creditors' commit-

(continued on page 7)

DEALING WITH THE INSOLVENT CUSTOMER: VENDORS MAY COLLECT TRANSFERS AS FRAUDULENT THAT CORPORATE DEBTOR'S SOLE SHAREHOLDER MADE TO HIMSELF (Continued)

(continued from page 6)

tee if the case is in Chapter 11, may compare the information contained in the bankruptcy schedules with financial statements the debtor recently prepared to determine whether any significant assets may have been omitted from the bankruptcy schedules or whether the debtor assigned dramatically different values to the assets. Debtors are required to disclose in their bankruptcy schedules any assets that were transferred outside the ordinary course of the debtor's financial dealings one year prior to the filing. The credit professional may also review the bankruptcy schedules to confirm the assets the individual debtor is seeking to exempt from the estate and verify the values the debtor has assigned to those assets.

The credit professional may also request a summary of payments and transfers by the Debtor for the year (and in certain states that may have extended reach back periods, up to four years) preceding the bankruptcy filing. As in the *Gaddis* case, a review of payments to the debtor's insiders may reveal significant transfers that may be recovered for unsecured creditors using the fraudulent conveyance laws. The *Gaddis* case underscores that a vigilant credit professional may find assets to pay on the delinquent account.

1. 234 B.R. 805 (Bankr. D. Ks 1999).

2. 234 B.R. at 812.

3. 234 B.R. at 812.

UCC SEARCHES IN THE COMPUTER AGE: A HYPHEN MAY MAKE A DIFFERENCE (Continued)

(continued from page 4)

those financing statements that are similar enough to the requested name to fall in the index.

Most states have adopted computerized filing systems in response to the flood of financing statements filed with the filing offices.

The *ITT Commercial* court recognized the shortfall of computerized searching as it is less flexible than manual searching. This is because the scope of the search used by computers retrieves only names that exactly match the requested debtor's name. Computerized searching does not retrieve alternative spellings of a debtor's name. The court noted that when searching for a hyphenated word, as was the debtor's name here, the search program ignores the hyphen and leaves a space in its place, with the result that a hyphenated name is treated as two separate words. A computerized search looks under each of those separate words of the debtor's name, but does not search under the combination of the two.

In determining whether an inaccuracy in the spelling of the debtor in the financing statement is a 'minor error' which was 'not seriously misleading' a court asks whether a reasonably diligent searcher would be likely to discover a financing statement indexed under the correct. In this regard the inquiry must question the extent of the discrepancy between the debtor's true name and that indicated on the financing statement so as to determine whether the filing gave the minimum information necessary to put any searcher on notice.

In *ITT Commercial*, the subsequent creditor's computer search did not uncover any lien filed under the debtor's name. The subsequent creditor argued that the financing statement must be filed under the exact name of the debtor or it would be seriously misleading to the searcher conducting a computerized lien search. The court agreed and found that the lien should be avoided.

A Credit Executive's Diligence With Lien

The *ITT Commercial* decision reminds the credit executive selling on a secured basis to make sure they properly record their financing statement using the debtor's exact legal name. In an era of computerized UCC searches, creditors must use the debtor's exact legal name in the financing statement or risk having their lien unseated. For a creditor, or creditors' committee, the *ITT Commercial* provides ammunition to challenge the validity of a creditor's lien, even where there may be a minor misspelling of a debtor's name on a financing statement. This may open the door for assets to pay unsecured creditors in the face of an insolvent debtor.

1. 166 F.3d 295 (5th Cir. 1999).

ESCHEATMENT: A PROBLEM FOR THE CREDIT EXECUTIVE? (Continued)

(continued from page 2)

adopted amnesty programs from escheatment violations. The amnesty program provides waiver of penalties for parties who come forward prior to October 31, 1999.

If your state has not adopted the amnesty program, the discussion should focus on whether to go to the state and reveal your omissions.

F. Steps to Protect the Vendor

A credit executive may take several steps to avoid escheatment claims. Review your company's bank reconciliation and uncashed checks. Determine whether outstanding checks to payees are really due. Filing with the appropriate states and governments. Credit professionals can also look to the following web sites for guidance:

National Association of Unclaimed Property Administrators: www.unclaimed.org

American Society of Corporate Secretaries: www.ascs.org

The Freedom Group: www.freedom.com

Recap Inc.: www.recapinc.com

G. Turning Over the Property

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

1. Mary Ludwig Schaeffer is the editor of IOMA's Report on Managing Credit Receivables and Collections. Other credit related articles may be viewed at the IOMA website (www.ioma.com).