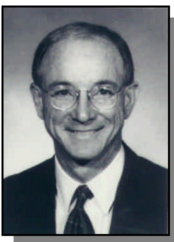
Blakeley & Blakeley LLP

Spring 2006
www.bandblaw.com

THE TRADE VENDOR QUARTERLY

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

CREDIT APPLICATIONS: TERMS TO BIND YOUR CUSTOMER



Mike Brittan
mike@nacmservices.com

Scott Blakeley
seb@bandblaw.com

A. Why a Credit Application?

The credit professional documenting the credit sale appreciates the importance of a credit application. A credit application can be central to setting forth the rights of the vendor in the event of a dispute with the customer. A credit professional may limit credit risk and address contingencies with an effective terms and conditions section of a credit application. The article discusses some of the key terms and conditions that a credit professional may consider to bind the customer. Mike Brittan discusses the credit application as a source of information and basic terms of the credit application, while Scott Blakeley discusses some terms and conditions that may aid the credit professional in resolving customer disputes. Mike's discussion is set out in sections "B" through "D" below, while Scott's discussion is set out in section "E."

B. The Credit Application as a Source of Information

There's only one place to gamble, and it's not with your company's profits. As hard as it might seem sometimes, the only time to get the information you really need to prevent a sheer 'roll of the dice' is at the beginning of the customer/vendor relationship. How many times have you been successful getting needed information after your company has already delivered to a customer? Think of it as though you are negotiating a deal. Your customer, (new or existing), wants your company's product/service without paying you today. You want information - today. It's a simple trade involving no exchange of money – today. If all goes well, you each get exactly what you want.

Absent getting a properly completed credit application, you may not have the leverage you need later. So use the leverage of asking for a few answers today in order to let your customer have the privilege of paying you later. If you allow credit application questions to go unanswered, you may find yourself explaining later to your boss, or a judge, why you did. Imagine yourself in front of your boss, or in a courtroom, being asked; "Mr/Ms. Jones, did you know the questions to ask in order to protect your company from unnecessary risk before you extended credit terms to this customer?" Of course you did. They were right there on your credit application. "Then why didn't you get the answers you were looking for

(*Continued on page 5*)

CONTENTS

Credit Application: Terms to bind your customer	1
Proofs of Claim—Is failure to document your claim grounds for disallowance?	1
Recovery of preferential transfers from international transactions by centering events domestically	2
Get Paid: Demand 'Adequate Assurance'	2
Selling to your Chapter 11 customer post-bankruptcy reform act: A new playing field?	3
Materialman's lien survives preference!	3
Using an arbitration clause contained in your credit application to collect (promptly) on your delinquent account	4

PROOFS OF CLAIM—IS FAILURE TO DOCUMENT YOUR CLAIM GROUNDS FOR DISALLOWANCE?

Bradley Blakeley
bblakeley@bandblaw.com

Upon a debtor's bankruptcy filing, a debtor must list all of its prepetition debts in its schedules. The debtor's schedules reflect whether each claim is disputed/undisputed, liquidated/unliquidated and contingent/noncontingent. The Bankruptcy Rules impose different filing requirements depending on whether the debtor has filed a Chapter 7, Chapter 13 or Chapter 11 bankruptcy petition. In a Chapter 7 or 13 case, the creditor must file a claim against the estate, even if its claim is scheduled as undisputed, liquidated and noncontingent. In a Chapter 11 case, if its claim is scheduled as undisputed, liquidated and noncontingent, the creditor either can accept amount scheduled as the amount of its claim or file a claim asserting another amount.

The bankruptcy court establishes a deadline in which all prepetition creditors must file their claims, and the burden is on the creditor to timely and properly file its proof of claim. The Bankruptcy Code, Bankruptcy Rules and Official Forms set forth specific requirements for filing a proof of claim. Under Bankruptcy Rule 3001(c), when a claim is based on a writing, the creditor must attach a copy of the writing to the proof of claim filed with the court. If the records are too voluminous, a summary of the account may be attached to the claim. A proof of claim executed and filed in accordance with the Bankruptcy Rules consti-

(*Continued on page 8*)

RECOVERY OF PREFERENTIAL TRANSFERS FROM INTERNATIONAL TRANSACTIONS BY CENTERING EVENTS DOMESTICALLY

Sandy Soo
ssoo@bandblaw.com

As the global marketplace continues to grow, and transactions involve multiple companies situated in different countries, the concentration of events in the United States is the key to successfully avoiding preferential transfers.

In March 2003, Florsheim Group Inc. ("Florsheim") filed for Chapter 11 protection. Florsheim subsequently brought suit to avoid transfers to a Taiwan-based company pursuant to 11 U.S.C. §§ 547 and 550.

During May and June of 2001, Florsheim, through the Taiwanese intermediary Roberts Trading Company ("Roberts Trading"), contracted for the purchase of shoes made by Glory Shoes Industrial Limited ("Glory Shoes"), a mainland China company, through its sales agent, USAsia International Corporation ("USAsia"). From the United States, Florsheim issued purchase orders to Roberts Trading. In Taiwan, Roberts Trading would translate the purchase orders into Chinese, and transmit the order to USAsia via email. USAsia, in turn, would provide notice of acceptance to Roberts Trading. Shipment of the shoes was arranged from China, with delivery to Florsheim in St. Louis, Missouri. The customs forms were filled out by USAsia.

Until Florsheim had the opportunity to inspect the goods and reject non-conforming shoes, Florsheim was not obligated to accept or pay for the shoes. Additionally, per the terms of the purchase orders and invoices, USAsia retained ownership of the goods until Florsheim paid for them. During the 90 days prior to filing bankruptcy, Florsheim wire transferred approximately $229,000 to USAsia's bank in Taiwan.

USAsia agreed that Florsheim received approximately $68,000 in subsequent new value following the above-payments, but denies that § 547 applies to the transfers.

The court believed answering the following three questions would resolve the issue: 1) where the transferred occurred; 2) did Congress intend for §§ 547 and 550 to apply to transfers occurring abroad; and 3) whether international comity weigh against the application of § 547.

First, the location of significant events. Rather than focus on a single factor to determine the location of financial transaction, the court considered the component events of the financial transaction. As other courts have, the Florsheim court applied the "center of gravity" test wherein U.S. law applies if the center of gravity is in the U.S.

Here, the majority of significant events occurred in the U.S.: 1) the purchase orders were issued in the U.S.; 2) the shoes were contractually required to be delivered in the U.S.; 3) Florsheim was not obligated to pay until it had an opportunity to inspect the shoes in the U.S.; and 4) payments for the shoes originated from a bank in the U.S. Taiwan, on the other hand, was the location of USAsia's bank that receiv`ed the funds.

USAsia argued that this case was similar to *Maxwell*, however, the court easily distinguished *Maxwell* because that case involved a foreign debtor that transferred funds from a foreign bank to a foreign creditor for debts that were incurred abroad.

(Continued on page 7)

FROM THE PUBLISHER:

***The Trade Vendor 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.**

Blakeley & Blakeley LLP cannot be held responsible for the accuracy of information contained in articles written by guest contributors. Readers' comments and questions are welcome and should be addressed to:

Scott Blakeley
Blakeley & Blakeley LLP,
Wells Fargo Tower,
2030 Main Street, Suite 210,
Irvine, CA 92614.

Telephone: 949-260-0611
Facsimile: 949-260-0613

Guest Column

GET PAID: DEMAND 'ADEQUTE ASSURANCE'

Douglas G. Fox
doug.fox@boschrexroth-us.com

Where a subcontractor or supplier has sold goods or provided services to a general contractor on credit and has reasons to believe that the general contractor may not pay [termed "grounds for insecurity" under Article 2 of the Uniform Commercial Code (UCC), which applies to contracts primarily involving the sale of goods], the subcontractor or supplier may demand written assurance that the customer will perform. Section 2-609 of the UCC provides:

a. A credit sale requires the buyer/customer, and the seller/supplier, to perform. Should grounds for insecurity arise with a buyer's performance, you may demand, in writing, assurance of performance. Until you receive such assurance, you may suspend performance.

b. The customer's failure to provide assurance within a reasonable time, not exceeding 30 days, repudiates the contract and you have no further obligation.

The rules are similar for contracts primarily involving the sale of services. The two questions for the seller who uses this remedy are whether the grounds for insecurity are reasonable, and whether the customer's assurance of performance is adequate.

For the subcontractor, determining whether a general contractor has materially breached the contract, justifying the subcontractor's refusal to perform, can be complicated and risky. However, by using its legal right to demand adequate assurances, a subcontractor or supplier can reduce its risk of loss and reduce its risk of wrongfully terminating a contract. (See sidebar for model Adequate Assurance Demand Letter).

Subcontractors may attempt to shortcut the legal requirements for adequate assurances by including in their credit documents the unilateral right to modify or terminate the extension of unsecured credit. Consider the following language for your company's credit

(Continued on page 9)

SELLING TO YOUR CHAPTER 11 CUSTOMER POST-BANKRUPTCY REFORM ACT: A NEW PLAYING FIELD?

Scott Blakeley
seb@bandblaw.com

The credit professional knows well that a customer's Chapter 11 filing means long delays before receiving any payment on the prepetition account, which payment is usually but a fraction of the claim. Traditionally, the vendor would file a proof of claim, perhaps serve on the creditors' committee, and press for a meaningful payment.

However, the credit professional has found that customers filing Chapter 11 may still provide an opportunity for sales especially if the vendor has had a substantial prepetition trade relationship. The credit professional, wearing the hat of relationship builder and working ever closer with sales, may try and find a way to continue to sell the customer in Chapter 11—even credit sales.

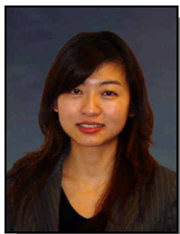
With the development of the critical vendor doctrine, vendors found themselves committing to long term sales contracts—on credit-in exchange for payment on their prepetition claims. Even those vendors that did not qualify as "critical"-an amorphous standard-considered selling their Chapter 11 customers with the added inducement of a junior lien on the customer's assets. Some vendors, eager to continue the sale of its goods or services, would sell without any credit enhancements.

Prior to October 17, 2005, vendors would often measure postpetition credit risk by whether the debtor had obtained postpetition debtor-in-possession financing. If a satisfactory DIP facility had been obtained, the vendor would sell on credit. However, with the arrival of the Bankruptcy Reform Act of 2005, the credit risk model used by credit professionals for selling to Chapter 11 debtors may have fundamentally changed.

A. The Bankruptcy Reform Act And The New Playing Field In Postpetition Credit Sales

(*Continued on page 10*)

MATERIALMAN'S LIEN SURVIVES PREFERENCE!



Shirley Chen
schen@bandblaw.com

Suppliers often provide labor and materials to contractors and subcontractors on credit since the contractor or subcontractor is generally not paid until the job, or a portion of it, is completed. Thus, an adequate lien is necessary to encourage responsible extensions of credit and maintain the health of the construction industry. A bankruptcy court recently discussed the effect of a debtor's payment on a materialman's claim after the fixing of a statutory lien but before its perfection. The decision reflects the court's policy to prevent trustee from recovering from vendors who supply materials to improve the value of the owner's property.

In *In re The Electron Corporation*, 336 B.R. 809 (10th Cir. BAP 2006), a mechanical company delivered goods and performed services for improvement of the debtor's real property in Colorado. The debtor paid the materialman $14,967 for goods and services rendered to the real property. The debtor later filed a Chapter 11 proceeding which was converted to a case under Chapter 7. The trustee sold the debtor's real property and sought to recover payment to the materialman as avoidable preference under 11 U.S.C. §547(b).

Section 547(b) of the bankruptcy code provides five requirements for a trustee to avoid payments by the debtor. In this case, the parties stipulated that the trustee met the first four requirements of §547(b). The dispute thus rested on the fifth requirement, which stated that a transfer would be avoidable if the transfer enabled a creditor to receive more than such creditor would receive if the case were under Chapter 7; the transfer had not been made; and the creditor received payment of such debt to the extent provided by the provisions of this title.

In looking at the fifth requirement of §547(b), the court noted that property interests of parties are defined by state law. Here, Colorado law recognized a statutory lien for materialman who "furnish or supply labor or materials to the extent of the entire contract price or for the value of the services upon such property." Colo.Rev.Stat. § 38-22-101. The court stated that a materialman's lien is "fixed upon the providing of labor or materials and is perfected by filing notice of a lien and a lien statement." Since the materialman in this case did not file a lien statement, the court focused on the effect of the debtor's payment on a materialman's claim after the fixing of a statutory lien but before its perfection.

Here, the materialman could have filed a materialman's lien under the Colorado statue if the debtor failed to make the payment. Because the debtor paid the materialman $14,967 for the services rendered, it did not file a material lien against the debtor. The trustee argued that in the absence of a perfection of the materialman's lien, the materialman was an unsecured creditor and could only receive a pro rata distribution with other unsecured creditors. The payment by the debtor thus would satisfy the fifth element because the materialman received more than it would receive.

The materialman argued that the fixing of the lien and the right to perfect it meant that it was never an unsecured creditor. The trustee could not satisfy the fifth requirement that the transfer enable the materialman to receive more than it would receive if the debtor's estate were distributed under Chapter 7.

The court concluded that when a creditor provided materials and services to the debtor and had the right to perfect a statutory lien, the creditor possessed an inchoate lien. Although the creditor did not perfect his or her lien, the statutory inchoate lienholder was not an unsecured creditor when at the time of the payments the lienholder remained eligible to perfect the lien pursuant to the state law.

The policy behind the court's decision is to protect inchoate statutory lienholder from taking the commercially unreasonable step of declining payment in order to perfect an inchoate statutory lien. Because under the Colorado law, the materialman's lien is fixed at the moment the materialman provided the labor and materials, the lien would not have been avoidable under the bankruptcy code. In addition, the trustee obtained more than the amount of any liens, the value of the collateral would have covered the materialman's claim and it would have received full payment.

Recognizing the central role played by

(*Continued on page 8*)

USING AN ARBITRATION CLAUSE CONTAINED IN YOUR CREDIT APPLICATION TO COLLECT (PROMPTLY) ON YOUR DELINQUENT ACCOUNT

Scott Blakeley
seb@bandblaw.com

The credit professional appreciates that a well crafted credit application's terms and conditions can reduce customer disputes and, perhaps, force payment on an overdue invoice. Often, a customer's failure to pay is based on cash flow problems, yet the customer may forestall payment by creating a dispute with the vendor that, say, the vendor's product was defective and therefore justifies withholding payment. In this setting after the credit professional has exhausted its pre-litigation collection efforts, the vendor may be forced to file suit in state or federal court to collect on the delinquent invoice. The ensuing litigation may take the vendor months, possibly much longer, before obtaining a judgment, depending on the defenses the customer raises.

By contrast, should the vendor be able to promptly present the dispute to a competent party that may expeditiously resolve the matter. The vendor may be better served of getting promptly paid on the delinquent account.

A. What Is Arbitration?

Binding arbitration is a formal collection process most like a vendor filing a collection suit in state or federal court. A vendor may invoke arbitration where the customer has agreed through the terms of a vendor's credit application to use an arbitrator to hear their dispute and resolve it through a binding judgment.

Arbitration is adversarial and intended to resolve the issues submitted by the parties, such as the customer's failure to pay. Arbitration differs from litigation as it does not conform with the legal rules of evidence, and the arbitration is conducted in a private rather than a public forum. Arbitration is not cheap, but arbitration is less time consuming, as arbitration moves quickly. The short deadlines that are arbitration creates and encourages the customer to settle the dispute. By contrast, where a vendor attempts to collect the delinquent account by filing suit, the vendor may face a court of delays that pressures the vendor to compromise. Another benefit is that a customer's claims cannot be heard by a jury, nor the risk of a sympathetic award to the customer, especially where the vendor has the economic power in the trade relationship. Arbitration also affords the vendor a party to resolve the dispute that is experienced in debtor creditor matters and commercial disputes, rather than a federal or state court judge that may be responsible for handling a variety of legal disputes, from insurance coverage to personal injury to antitrust. The credit application should contain a venue provision that requires your out-of-state customer to arbitrate in your local courts.

1. Agreement to Arbitrate

An arbitration clause that is provided for in the credit application, unlike arbitration agreement contained in a consumer contract that has been found to be unenforceable in certain situations, an arbitration provision contained in a credit application in a B2B transaction is enforceable. A vendor may require a new customer to agree to arbitration as a condition of sale, in a clause such as:

> "Any controversy or claim arising out of this credit application, or sales thereto, or breach thereof, shall be resolved by arbitration, in accordance with the rules of the American Arbitration Association, and judgment rendered may be entered in the highest state or federal court"

Should the customer agree to the arbitration clause contained in the credit application, must a court, even a bankruptcy court, enforce the commercial arbitration clause in the face of a customer later objecting? For example, *In re Winstar Communications, Inc.,* the bankruptcy court found that an arbitration clause in a contract should be honored, notwithstanding the trustee's objection.

B. Recent Court Treatment of Arbitration Clause

In *In re Winstar Communications, Inc.*, the debtor contracted to sell its assets. A dispute ensued resulting in the trustee suing the buyer in bankruptcy court. The buyer responded to the lawsuit by invoking the arbitration clause in the contract. In determining whether the dispute should proceed to arbitration, the court considered whether there was an enforceable arbitration clause, and if the arbitration clause was enforceable, whether the court had discretion to deny enforcement of the arbitration clause.

The court looked to section two of the Federal Arbitration Act, which provides that a written provision in a commercial contract involving to settle by arbitration would be enforceable. The court found that the arbitration clause applied to the dispute, the contract provided as such. The trustee argued that by using the term "may arbitrate" instead of "shall" or "must," the provision did not mandate arbitration. The court disagreed, concluding that the arbitration provision, once raised by a party, became mandatory. The court deferred to the arbitration clause agreed upon by the parties to resolve the dispute.

C. In Action Arbitration

Consider the following: You have sold the customer on open account. You have documented the sale with a credit application, which contains an arbitration provision. The customer fails to pay and refuses to respond to your requests for payment. You invoke arbitration by sending an arbitration demand letter to the customer. What are your next steps?

Before attending your arbitration hearing, you should prepare an outline of your argument to help you in your presentation. State the dispute and why the customer is indebted. For example, did the customer provide reasons as to why they refused to pay. At this point, having a provision in the credit application that imposes on the customer a duty to inspect the goods provided or services performed and object within a specific period, including objecting to the documentation can eliminate several defenses by the debtor. If the customer fails to timely object, then they have waived their right to object to payment. List the actions you have taken to resolve the dispute, the individuals spoken to, what information they told you and actions taken. Written statements from witnesses can help substantiate the facts of your case.

You should bring to the arbitration all documents relating to the dispute, with copies for the arbitrator and the customer, such as: Purchase orders, invoices, order acknowledgments, credit application, shipping documents, correspondence, including hard

(Continued on page 13)

CREDIT APPLICATIONS: TERMS TO BIND YOUR CUSTOMER

(Continued from page 1)

before you extended terms?" Mr./Ms. Jones: "Umm…er….well…" It's a dubious position. You have only two possible answers: "I guess I was, maybe… stupid". Or, "I was a conspirator in this misdeed". Either answer is not a particularly good career builder.

C. The Credit Application as a Contract

A properly executed credit application is a binding contract when there is agreement to the terms and conditions. Remember, you are negotiating. You want to put as many provisions as you can think of in the agreement that will protect your company from risk of loss due to default or other adversarial relationship that may arise during the course of business with customers. Negotiation means you won't *always* get *everything* you want in your contract. But it does mean that you will get what you want a heck of a lot more often if you ask it than if you don't. So, don't be shy.

A customer may negotiate a condition or two, or a term or two out of your credit application, but that may be okay, depending on what they are. But this is your company, this is your contract, and your credit application should be a reflection of the trials and tribulations your company has experienced getting paid by customers in your industry over time. Therefore, include what you think is best to cover every situation you have experienced and contract to avoid those occurrences from again presenting themselves.

D. Basic Terms of the Credit Application

1. What is the Legal Name of Customer's Business?

If it becomes necessary to go to court, you have to bring action against the correct person or entity. If you don't have the right name, it's like being sued for something your cousin did (or didn't do) and will be dismissed by the court because the right being isn't named. Maybe your customer doesn't even know the legal name of the business. In some industries this is not really that unusual. If you are extending credit to a company in one of these industries then, before you file suit, research the Secretary of State or local licensing records or have your attorney do so before entering your Motion for Judgment. Otherwise, you may lose before you get started.

2. The Entity Itself

Sometimes, when answering the first question the customer gives you an indication of the type of entity they are. But still, I highly recommend a specific area on the credit application asking; Corporation or LLC? Proprietorship or Partnership? How your customer is formed describes the very Nature of the Beast and tells you how and against whom you will proceed in the event of default. For example: You will need Personal Guarantees if you expect to pursue a debtor in court who is incorporated or is structured as an LLC.

3. Trade References and Information Exchange

You should get references. Ask for trade references on your credit application. How much weight your credit decision deserves using references given by the customer is always a source of debate. The idea is to get the customer to tell you from which other suppliers or vendors from which they currently buy on open account. Then you go about checking with those sources how your new customer might be expected to pay you should you decide to give them open credit terms. Good plan. But wait. If your customer has good references then, surely, those are the ones you can expect to see. Remember, any of us when asked to give references are going to try to think of the best ones we can give. Who doesn't want to put their best foot forward? Knowing other suppliers inside and outside the industry can provide additional sources of information if you get that little gnawing feeling in the back of your head that says something more is needed. Never, never stop asking questions if ever you feel like something just isn't adding up.

The best way to properly exchange credit information on a customer is to remember the basic rule of "past and completed transactions only". Also, never offer subjective information, opinions, anectdotal information or financial information about a customer and be careful giving a telephone reference unless you are certain the person with whom you are discussing the account is someone who has a reason to have the information they are requesting and knows how to treat the information you give them in the confidential manner required by all good credit managers.

4. Bank Information

Hard to get and then, when you do, what does it really say. Well, reading between the lines when you successfully obtain bank information requires a bit of experience and acquired knowledge. I address in this article getting the bank to respond. That's why I like a short statement authorizing the bank to release the information that customer has agreed to let us ask with a separate signature line for the customer specifically authorizing the bank to release information on the account(s):

"I hereby authorize the bank named herein to release information requested for the purpose of obtaining and/or reviewing my company's credit from time-to-time" Add a separate signature line to this area of your credit application, have the customer sign and send it off with your request.

5. Agreement to Terms and Conditions of Sale and Credit Policy

Make your terms and credit policy legally binding on your customer(s). Your credit application is a document that sets forth the agreement between you and your customer and describes, identifies and otherwise defines the terms and conditions upon which you and that customer are going to do business. A good credit application will usually save your business legal fees. A statement describing when payments are due and where payments are to be made is all we are looking for here: *"All invoices are due [per your company terms]. All amounts due for purchases from [your company] are payable at [address]. C.O.D. restrictions may be placed on any past due account. I (we) agree to pay account promptly within terms stated."*

6. Charging Interest

As with most calls I get on this subject, the member is worried about State Usury Laws. Most State Usury Laws deal with consumer transactions not commercial transactions. But, as we all know, the good ole' commercial customer might just buy something on his/her commercial account and then use the products or merchandise for personal or household use thus slipping

(Continued on page 6)

CREDIT APPLICATIONS: TERMS TO BIND YOUR CUSTOMER

(*Continued from page 5*)

into a consumer transaction as defined by law and now you, the unsuspecting creditor, are charging interest rates at Usury levels.

Absolute correct method and language for charging interest legally in every state – regardless of Usury laws is: All invoices are due (**Your Company terms**). A service charge of one and one half percent (1-1/2% per month), or (18% per annum) or the highest legal rate, which ever is less may be assessed on delinquent invoices.

7. Change of Ownership

Avoid the 'Goldilocks Syndrome' – the shock and awe of finding new owners (the Wolf) in your customer's house (Grandma's Bed). *"We [customer] understand that we must notify [your company] in writing, and by certified mail of any change in ownership, the name or the business structure under which credit is established.* This language may further, and possibly personally, bind the customer who sells the business to a new owner or changes the status of the entity at later time.

8. Certification of Use of Credit

"I (We) certify that this request is for the extension of credit for business purposes only and is not intended for the extension of credit for personal, family or household purposes". Language of this nature could quickly eliminate another defense by a customer who utilized the company credit established with you for other than resale or service purposes.

9. Signature

"The person executing this agreement has authority to bind the customer and is authorized by the customer to enter into the credit application terms and conditions". This language ensures that even if the signer is not an officer or executive of the company, the company is still legally bound.

Still more provisions can be included in the credit application; "No Modification", "Personal Guaranty", "Right of Offset", "ECOA Statement", "Authority to Investigate", "Accurate Information". Some other terms and conditions that may resolve customer disputes are considered by Scott Blakeley below.

E. Terms and Conditions that may Resolve Customer Disputes

1. Waiver/Duty to Inspect

You want to know at the earliest opportunity whether your customer has concerns regarding the product you shipped or service provided. To that end, consider requiring your customer to inspect and complain within a specific period. By imposing on your customer a duty of early inspection and objection, and a waiver if the customer fails to do so, strengthens your case for prompt collection of the delinquent account. Consider:

Applicant also agrees to examine immediately upon receipt, each of [Creditor]'s statements, and to advise [Creditor]of any disputed transactions or statements within 10 days of receipt, together with a written statement specifying the reasons for such dispute. Failure to notify [Creditor] of any dispute with respect to defective goods or billing shall constitute a waiver of all such disputes.

2. Attorney's Fees

Should your customer be required to pay your attorney's fees and costs if you are forced to file suit to collect on the delinquent account, your customer may reconsider and pay the account. The general rule is that each side must carry their costs to collect and defend a collection suit. However, if you include a provision in your credit application that your customer pays, you can shift these costs. Consider:

Applicant further expressly agrees that it shall be liable and pay all attorneys' fees, collection costs and court fees, and any other expenses, whether or not incurred in connection with litigation, including but not limited to attorneys' fees and costs associated with the enforcement of any of the terms of this Application and attorneys' fees and costs resulting from a default under this Application.

3. Venue

If you are selling an out-of-state, or out-of-country customer, you want any legal disputes with that customer, including any collection suit, to be brought in your home court. To that end, a venue provision in your credit application provides you with that right. The venue provision may force your customer to reconsider payment on the delinquent account given that they would have to come to your home court to defend against the action. Consider:

Applicant agrees that all issues and disputes relating to any credit arrangement extended hereunder shall be governed in accordance with a competent jurisdiction chosen at the discretion of [Creditor] and that Applicant expressly waives its venue rights without reference to conflicts of laws principles.

4. Escheatment/inactivity

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. Escheatment includes all forms of property, both tangible and intangible, including a customer's credit balance. Escheatment laws provide that the state becomes the legal owner of abandoned property, based on the concept of state sovereignty. To write down a vendor's escheatment exposure, a credit professional may consider imposing an inactivity fee to the credit balance. Consider:

[Creditor] imposes an inactivity fee of $______ per month against any credit balance presumed abandoned by Applicant. An account is presumed abandoned if there is no activity for one year.

[Creditor] reserves the right to assess a monthly service charge on account paid outside credit terms to the maximum amount permitted per jurisdiction.

5. Arbitration/Mediation

When a customer fails to pay according to credit terms, and the failure to pay is about the customer's cash flow and not a dispute over the product or service provided, you want to get a judgment fast, when your other collection efforts have been exhausted. However, filing a collection suit in some jurisdictions can be time consuming, especially with courts in metropolitan areas. These courts may be backlogged with a variety of law suits and, therefore, may take you far to long to collect. To press for payment, consider a provision in your credit application that pro-

(*Continued on page 7*)

RECOVERY OF PREFERENTIAL TRANSFERS FROM INTERNATIONAL TRANSACTIONS BY CENTERING EVENTS DOMESTICALLY

(*Continued from page 2*)

As the center of gravity in *Maxwell* was not in the U.S., U.S. law did not apply to the preferential transactions of that case.

Second, Congressional intent. Unless a contrary intent appears, Congress intends for its legislation to apply only within the United States.

Third, international comity. Comity is the acknowledgment of the executive, judicial, or legislative acts of another country which may apply to persons or activities involving that other country. The application of U.S. law depends on reasonableness. The courts consider factors such as "location of the regulated conduct; the connections between the United States and the conduct, parties, and protected class; the nature of the regulated conduct; whether the conduct is generally proscribed elsewhere; the expectations of the parties; the interests of other affected nations; the importance of the regulation; and the likelihood of actual conflict with other nations' laws." *Restatement* §403.

USAsia argued that international comity weighed against the application of §547 because it only had minor connections to the United States; the transaction occurred outside the United States; it could not have anticipated the application of U.S. law; preferential transfers are not of national importance; and insolvency laws conflict with local credit practices. The court rejected all of USAsia's arguments because there were substantial connections with the United States; the transfer of funds originated in the United States; not only did USAsia voluntarily entered into the relationship to sell shoes to Florsheim, USAsia completed customs paperwork, shipped the shoes to the United States and retained ownership of the shoes until they were accepted by Florsheim; recovery of preferential transfers is important as a source of funds for creditors; and concerns of international comity were not raised with mere inconsistencies.

As such, the court held that the preferential transfers were avoidable. Per the parties' agreement regarding recovery, Florsheim will receive $115,000, plus interest.

While the marketplace is now global, and the internet makes international communications easier, keeping the U.S. as the location of key events of a transaction benefits the creditors.

CREDIT APPLICATIONS: TERMS TO BIND YOUR CUSTOMER

(*Continued from page 6*)

vides that you may submit your claim to binding arbitration. Often, the arbitration can be set in a matter of days and you can get an arbitrator experienced in collection or business disputes. Consider:

Applicant agrees that Applicant will submit all disputes to final and binding arbitration, in _______________, in accordance with the rules of the American Arbitration Association or the National Association of Arbitrators. Applicant agrees to be bound by the arbitrator's decision.

6. Terminating the Credit Sale

You agree to extend terms to a new customer only to learn prior to delivering your large order that your customer may be in financial difficulty. You now believe, that, although the customer has not defaulted under the terms of sale, that the customer likely will not be able to pay for the credit sale. You want to convert your credit sale to a cash transaction. You are better off converting the credit transaction to cash if you have in your credit application the unilateral right to terminate the credit sale, rather than having to send a letter demanding adequate assurance. Consider:

[Creditor] reserves its right, at its sole discretion and without notice, to cancel all available credit and refuse to make future advances.

7. The Fair Credit Reporting Act Authorization

The Fair Credit Reporting Act generally requires a trade credit grantor to obtain written authorization from an individual to run a consumer credit report. A separate form, or addendum to accompany the credit application, should be considered, as the party that the credit professional seeks authorization to pull the credit report may not be the same party that signs the credit application. A credit application that provides general authority for the credit professional to pull a consumer credit report on a corporation's officers may be insufficient. Consider:

The undersigned consents to [Creditor] obtaining a consumer credit report on _________ [Name of sole proprietor/ President/Officer of corporation, LLC, partnership] for the purpose of evaluating the creditworthiness of __________ [Name of sole proprietor/ President/Officer of corporation, LLC, partnership], in connection with this Application.

Signed By:

____

[Name of sole proprietor/President/ Officer of corporation/LLC/partnership]

FCRA Authorization Contained in Personal Guarantee

The undersigned consents to [Creditor] obtaining a consumer credit report on _________ [Guarantor] for the purpose of evaluating the creditworthiness of _________[Guarantor], in connection with an application for business credit.

Signed By:

____

[Guarantor]
[Social Security Number and home address]

A Credit Application Helps Make Sound Credit Decisions

A well crafted credit application can be the source of information from your customer that can be the basis of making a sound credit decision, including whether a credit enhancement, such as a personal guarantee, may be needed. The terms and conditions of the credit application, likewise, can also protect the vendor from credit loss by leveraging the customer to pay you.

Mike is the President & Chief Operating Officer of NACM MidAmerica. The association now provides commercial credit bureau services in several Midwest states and nationally through numerous partnership alliances with other associations.He is a graduate of Kansas Newman University and studied law at Oklahoma City University's School of Law, Night Division.

PROOFS OF CLAIM—IS FAILURE TO DOCUMENT YOUR CLAIM GROUNDS FOR DISALLOWANCE?

(*Continued from page 1*)

tute prima facie evidence of the validity and amount of the claim.

However, an issue arises when the creditor fails to attach any writing or sufficient writing to its proof of claim and the debtor objects to the claim on this basis. These are facts faced by the Bankruptcy Appellate Panel (BAP) of the Ninth Circuit in the case of *In re Heath*, 331 B.R. 424 (9th Cir. BAP 2005). In *Heath*, the Chapter 7 debtors objected to credit card issuers' proofs of claim as lacking necessary documentary support. The bankruptcy court entered an order overruling debtors' objections and allowing claims, and the debtors appealed.

In *Heath*, the debtors filed their bankruptcy Schedule F (general unsecured claims) listing twelve credit card debts, without designating any of them as disputed, unliquidated or contingent. Several holders of these credit card debts filed proofs of claim, all in slightly higher amounts than what debtors listed in their Schedule F, and the debtors filed objections to eight proofs of claim on the grounds that no supporting writing was attached to it as required by the Federal Rules of Bankruptcy Procedure, Rule 3001 (c). The bankruptcy court and the BAP determined that a claim not filed in conformity with the Bankruptcy Rules is not entitled to the evidentiary presumptions of validity and amount.

At a hearing on the debtors' objections, the bankruptcy court noted that the debtors had acknowledged the approximate amounts of their debts to the creditors on their bankruptcy schedules. It concluded that it would overrule one objection because the creditor was served at the wrong address and would allow the remaining seven claims, reducing the amount of each to what was listed in the schedule. The debtors filed a motion for reconsideration, which was denied, and appealed the order on the motion.

The creditors argued that the debtors' should be estopped from objecting to the claims, as they listed the claims on their schedules as undisputed, liquidated and noncontingent. The bankruptcy court and the BAP did not adopt the creditors' position. The BAP acknowledged that bankruptcy schedules can constitute admissions under the Federal Rules of Evidence, but the BAP found that amendments to bankruptcy schedules are permitted "as a matter of course" any time before a case is closed. As such, the BAP did not find that an argument of estoppel or admission supported the bankruptcy court's ruling.

Instead, the BAP directly addressed the issue of whether a creditor's failure to attach writings to a proof of claim requires a bankruptcy court to disallow a claim on that basis alone. The BAP analyzed the reported decisions on the issue and found that courts are split on the issue.

As the minority view, the BAP found that where a proof of claim is not entitled to prima facie validity under Rule 3001(c) and (f), it is a sufficient basis by itself to disallow the entire claim if the creditor does not amend its claim within a limited time, such as by the deadline to respond to the objection to their claim. One justification for this minority approach is the burden to debtors or a trustee who should not have to incur the cost of making a claims objection based on lack of supporting documentation when the Rules initially place the burden of providing support on the creditor, combined with the practical difficulties of obtaining accurate and complete information from institutional holders of credit card debt who frequently are not the original holder. However, the minority decisions do not address the majorities' basis for their decisions.

Under the majority view, the courts are bound by the plain meaning of Bankruptcy Code sections 501 and 502. When a creditor files a proof of claim, that claim is deemed allowed under sections 501 and 502(a). Section 502(b) sets forth the exclusive grounds for disallowance of claims, and the debtor has to introduce evidence or arguments to establish any of those grounds. Noncompliance with Rule 3001(c) is not one of the statutory grounds for disallowance.

The BAP when on to state, however, that creditors have an obligation to respond to formal and informal requests from the debtor for information, and the obligation to respond applies regardless whether creditors have met their obligation to provide a summary under Rule 3001(c). If the creditor does not provide information or is unable to support its claim, then that in itself may raise an evidentiary basis to object to the unsupported aspects of the claim, or even a basis for evidentiary sanctions, thereby coming within Section 502 (b)'s grounds to disallow the claim.

The *Heath* decision provides creditors with clarification as to standards of proof, documentation requirements and the burden to communicate with the debtor regarding their claim. The decision does impose a stricter standard on debtors concerning the basis of their objections. However, it underscores the importance for creditors to attach complete documentation in support of their claim, or, if too voluminous, then a detailed summary. It also reminds debtors and creditors of the importance to communicate regarding the basis of the claim and attempt to resolve any discrepancy informally.

MATERIALMAN'S LIEN SURVIVES PREFERENCE!

(*Continued from page 3*)

credit in the construction industry, the court articulated the importance of an adequate lien for suppliers of materials and labor. A vendor's interest is protected when no forfeiture of the contract was intended and justice required that the lien be preserved to the extent that the owner's property was improved.

Guest Column

GET PAID: DEMAND 'ADEQUTE ASSURANCE'

(*Continued from page 2*)

applications, subcontracts or purchase orders:

> If the Buyer fails to fulfill [mitigated by any Force Majeure clause] the terms of payment of any invoice or if the financial responsibility of the Buyer shall become impaired or unsatisfactory to the Seller, or if necessitated by any acts of any governmental authority, the Seller reserves the right to change terms of payment and/or deter or discontinue further shipments without prejudice to any other lawful remedy, until past due payments are made and satisfactory assurances of Buyer's credit standing are received by the Seller or until such acts or requirements of such governmental authority shall have been complied with.
>
> The Seller also reserves the right in the case of any of the foregoing events to cancel the contract, in which event the Buyer shall compensate the Seller for any commitments, obligations, expenditures, expenses, and costs including attorney fees, the Seller may have incurred in connection with the contract.
>
> For sales of goods, each shipment by the Seller shall be considered a separate transaction and if payment is not received therefore within the periods specified herein, the Seller at its option may bring a separate suit to recover the contract price of each such shipment.
>
> If any of the following events occur, Seller shall have the right to demand assurance from Buyer that payment in full will be made:
>
> 1. Buyer is delinquent in making payment hereunder for a period of 45 days after payment was due.
>
> 2. Buyer fails to meet his obligations with one or more other subcontractors or suppliers as the obligations occur.
>
> 3. A Writ of Attachment or Judgment is entered in any court of competent jurisdiction.
>
> On written demand for assurance by Seller, Buyer shall, within five (5) days after receipt thereof, furnish, in amount sufficient to secure the full payment of the balance of any monies due hereunder on account of the purchase price, either a penalty bond issued by a financially solvent surety company, or financial security, bank irrevocable letter of credit, or other liquid collateral to be held in escrow by an attorney at law as designated by Seller, to secure the payment of the purchase price aforesaid.

It may be difficult for a subcontractor to use this language on public construction projects, where it is common for the owner and general contractor to agree that the general contractor may not stop its performance for any reason. In many cases, these provisions "flow down" to subcontractors and lower-tier subcontractors. However, adequate assurance arguably is already given to subcontractors on most public work in the form of a payment surety bond guaranteeing payment of subcontractors.

Douglas G. Fox, is Contracts Manager, Systems & Engineering, Bosch Rexroth Corporation. He can be reached at doug.fox@boschrexroth-us.com. An earlier version of this article was published in June 2004 by the Credit Research Foundation.

Model Adequate Assurance Demand Letter

Transmit VIA Facsimile Tel. # nnn-nnn-nnnn AND overnight courier

Date

Addressee

Re: *Demand for Adequate Assurance*

Dear [Addressee]:

[XXX] makes demand on [Debtor] to provide [XXX] with adequate assurance of performance of the credit sale.

On [date], [provide reasonable grounds for insecurity]. Accordingly, Debtor's statements show that Debtor is unable to pay as required.

Pursuant to Uniform Commercial Code §[section number], as adopted by [state] Uniform Commercial Code §[section number], and pursuant to the common law of contracts, a seller has the right to adequate assurance of due performance from the Buyer where reasonable grounds for insecurity arise. Additionally, after submitting a written request for adequate assurance, the seller may, if commercially reasonable, suspend any performance for which the agreed return has not been received. Furthermore, the Buyer must provide adequate assurance of performance within a reasonable period of time.

Debtor's [action by debtor] creates the requisite insecurity that [XXX] may suspend performance. Additionally, Debtor's statements that it is unable to pay for services, and its current financial condition, lead to the conclusion that it is insolvent. Insolvency alone is sufficient to request cash payment for any future shipments of goods and performance.

Please provide [XXX] with adequate assurance that Debtor's future obligations will be performed no later than [date].

Very truly yours,
[XXX]

nnn-nnn-nnnn tel.
nnn-nnn-nnnn fax
aaa@aaaaa.com

SELLING TO YOUR CHAPTER 11 CUSTOMER POST-BANKRUPTCY REFORM ACT: A NEW PLAYING FIELD?

(*Continued from page 3*)

On April 20, 2005 the U.S. Bankruptcy Code was finally overhauled, with the passage of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. Most provisions of the Reform Act became effective with bankruptcy cases filed after October 17, 2005.

The changes to the bankruptcy laws were intended in large part to make it more restrictive and burdensome for consumers to escape their debts. The perception of the consumer in response to the legislation was to file Chapter 7's in record numbers prior to the effective date of the Reform Act.

The Reform Act also has made a number of significant changes to provisions affecting the commercial creditor. Indeed, much of the Reform Act's changes to the provisions affecting commercial creditors reflect special interest legislation. The overall impact of these special interest changes may make it more difficult for the Chapter 11 debtors to survive their reorganization, thereby making it more difficult for vendors to receive payment on their postpetition credit sales.

B. Debtor's Cash Availability Restricted Post-Reform Act As A Result Of Provisions Favoring Special Creditor Interests

The below chart contains the provisions in the Bankrutpcy Reform Act that take cash away from the debtor so as to pay vendors for the postpetition credit sales (as well as limited payments on prepetition creditor claims).

1. Employee Wages

Prior to the 2005 Reform Act	Under the 2005 Act	What It Means For Vendors
Employee wages are listed as third in priority over other expenses and claims. The priority is only to the extent of $4,000 for each individual or Corporation. Wages must be earned within 90 days before the date of filing of the petition or the date of the cessation of the debtor's business.	Employee wages and salaries are fourth in priority over other expenses and claims. The amount of priority is increased to $10,000 for each individual or corporation. The earning period is extended to 180 days before the date of the filing of the petition or the date of the cessation of the debtor's business.	More of the debtor's cash is dedicated to employees' claims which results in less cash available for operations, including vendors postpetition credit sales.

2. Landlord Claims

Prior to the 2005 Reform Act	Under the 2005 Act	What It Means For Vendors
A debtor has 60 days from the bankruptcy filing to decide whether to assume or reject its commercial real estate lease. A bankruptcy court routinely extended this time during the course of the bankruptcy case.	A debtor must assume or reject its estate lease within 120 days following the petition date. A court may extend the 120 day period to assume or reject for up to an additional 90 days. Further extensions require the lessor's consent.	A debtor may be forced to prematurely assume and to continue to pay the rent, only to determine later that the early assumption was wrong. Further, the debtor must cure the landlord's prepetition claim. The administrative cost of a Chapter 11 case may be increased as the consequence of forcing the debtor to decide to assume or reject a real estate lease by an earlier deadline.

(*Continued on page 11*)

SELLING TO YOUR CHAPTER 11 CUSTOMER POST-BANKRUPTCY REFORM ACT: A NEW PLAYING FIELD?

(*Continued from page 10*)

3. Utilities

Prior to the 2005 Reform Act	Under the 2005 Act	What It Means For Vendors
The time by which a debtor must provide adequate assurance to a utility is 20 days. There was much litigation between the debtors and their utilities, including telecom debtors and the telephone utilities, as to how to provide assurance of payment to the debtors.	A debtor offering a utility administrative expense claim no longer constitutes adequate assurance of payment. Adequate assurance of payment is limited to: a cash deposit; a letter of credit; a certificate of deposit; a surety bond; a prepayment of utility consumption; or another form of security that is mutually agreed on.	This provision requires debtors to provide utilities with cash deposits or credit enhancements during the early stage of the Chapter 11. The debtor is required to have more assets to satisfy a utility's adequate assurance requirements which means that there are less assets available for trade creditors both on account of their prepetition debt as well as post-petition credit sales.

4. Reclamation

Prior to the 2005 Reform Act	Under the 2005 Act	What It Means For Vendors
The law required that the seller's demand for reclamation be made in writing; and in certain circumstances extends the notice period from ten to twenty days.	Bankruptcy Code still requires the vendor's demand for reclamation in writing. The notice period has been significantly lengthened. The Bankruptcy Code provides the bankruptcy court with the ability to grant a seller a lien or priority claim in lieu of the goods. If a vendor makes a reclamation demand within 45 days after the debtor receives goods, the debtor must pay for, or return the goods.	The 2005 Act no longer permits the bankruptcy court to provide a priority claim or lien, when the court does not allow the vendor to reclaim the goods. Provided the vendor can establish the elements of a reclamation claim, the extension of the reclamation period to 45 days may open the door to significantly more types of goods to be reclaimed, and lead to larger administrative claims asserted by vendors. Larger administrative claims may pose a risk that a debtor may not be able to pay theses administrative claims, and thus jeopardize its exit from bankruptcy.

(*Continued on page 12*)

SELLING TO YOUR CHAPTER 11 CUSTOMER POST-BANKRUPTCY REFORM ACT: A NEW PLAYING FIELD?

(*Continued from page 11*)

C. Credit Sales Alternatives Post-Reform Act

1. Selling on Credit Postpetition

To encourage vendors to sell a debtor on credit postpetition, the Bankruptcy Code provides that should the debtor default on the credit sale, the vendor is entitled to an administrative claim for the unpaid balance. The vendor should be mindful that while the Bankruptcy Code provides for priority status for unpaid postpetition invoices, a vendor holding a priority claim is not guaranteed payment. Rather, a debtor could find itself administratively insolvent, especially given the changes noted above under the Bankruptcy Reform Act. Moreover, a debtor's obtaining debtor in possession financing is also not a guarantee that a vendor's postpetiton credit sale will be honored. Should the vendor become administratively insolvent in its Chapter 11, the vendor's priority claim could go unpaid.

2. Junior Lien Sales

Those vendors that do not qualify as critical, a debtor may offer vendors a junior lien on assets in exchange for selling on credit. The purpose of the junior lien is to reduce the risk that if the debtor fails to pay for the credit sale, the vendor may have some assets to look to for payment. However, the junior lien sale does not pay a vendor's prepetition claim. Given the changes under the Bankruptcy Reform Act, there may be fewer assets in which a senior secured creditor, which means fewer assets available, if any, for the junior lien creditor. Like with credit sales postpetition, the vendor must be more vigilant in assessing postpetition credit risk.

3. Sale of Claim

A vendor may elect to sell its prepetition claim to a third party, rather than wait for a distribution through a plan. Third parties, unrelated to the debtor, offer to purchase a trade creditor's prepetition claim, at a discount. Given the changes under the Bankruptcy Reform Act, claims buyers may insist on a greater discount from vendors on the face value of their claims, given the increased risk of a Chapter 11 debtor being forced to liquidate.

Unlike the critical vendor doctrine, a vendor does not have a continuing obligation to sell the debtor on credit when it sells its claim to a third party. Also, unlike the traditional critical vendor doctrine, a vendor selling their claim does so usually at a steep discount.

4. The Critical Vendor Doctrine

To be classed as "critical" by a Chapter 11 customer is usually an extraordinary result for the vendor as it means payment in full or a substantial portion or the prepetition claim, given the alternative of waiting, perhaps for years but for a fraction of the prepetition claim. However, a Chapter 11 debtor's funds available for the critical vendor class is limited, as well as scrutinized (and perhaps objected to) by lenders, bondholders, noteholders, a creditors' committee, the U.S. Trustee's office, and even competing vendors who want to be elevated to critical vendor status.

The payment of claims deemed critical is to induce vendors to continue supplying key goods and services post-bankruptcy on credit, which may enable a debtor to continue to operate and, perhaps, exit bankruptcy. In exchange for the vendor being paid in full, the debtor conditions the vendor extending comparable credit terms postpetition. The critical vendor agreement is reflected in a letter agreement between the debtor and the vendor. The agreement also provides for a "claw back" provision that permits the debtor to recapture the critical vendor payment if the vendor refuses to continue to extend credit.

The vendor needs to reconsider selection as a critical vendor. Given the changes under the Bankruptcy Reform Act, and given that a vendor is usually required to commit for a substantial period of postpetition sales on credit, a vendor should reconsider the postpetition credit risk that a critical vendor commitment takes.

a. The Catch Up Issue

If the vendor does not qualify as a critical vendor, the vendor may resolve to find an alternative to have its prepetition claim paid. A general principle of the Bankruptcy Code is that a vendor may not be paid on its prepetition claim postbankruptcy, absent a court order or a confirmed Chapter 11 plan. However, a vendor may attempt to have the debtor pay down its prepetition debt by inflating its postpetition invoices. This "catch up" scheme may be illegal, and can result in disgorgement of the inflated invoices and, possibly, criminal action.

D. Reform Act Impact May Mean More Pre-Bankruptcy Negotiations By Debtors And Creditors

Given the increased risks of liquidation that a Chapter 11 debtor now faces as a result of the Bankruptcy Reform Act, the customer may consider a faster exit from Chapter 11.

1. Payment of All Vendors' Claims Through Prepackaged Plan

If a debtor is contemplating Chapter 11, it may negotiate with its major creditor constituiencies, such as bondholders and noteholders, with hopes to reach agreement as to their treatment under a plan of reorganization. These prepetition negotiations may result in a consensus for treatment not only as to bondholders and noteholders, but vendors as well. The prepetition consensus results in a debtor's quick exit from Chapter 11.

For example, in the Trump Hotels bankruptcy, a prepackaged plan was filed that proposed to pay all vendors prepetition claims in full. The debtor did not wait to pay vendors until the plan of reorganization was confirmed, but obtained court approval to pay all of the vendors claims shortly after the Chapter 11 filing. From the vendors' view, this may be viewed as a "super critical" vendor motion, given that all vendors' prepetition claims were to be paid. As the plan of reorganization had been prearranged, the court approved the early payment of all of the vendors, without the debtor going through the rigors of meeting the critical vendor elements.

E. Post-Confirmation Credit Risk: Reform Act Does Not Bar Chapter 22

Notwithstanding the Reform Act provisions that take cash from a Chapter 11 debtor, should a customer confirm their Chapter 11 plan, the Reform Act does not bar the customer from filing a second Chap-

(*Continued on page 13*)

SELLING TO YOUR CHAPTER 11 CUSTOMER POST-BANKRUPTCY REFORM ACT: A NEW PLAYING FIELD?

(Continued from page 12)

ter 11, should they default on the terms of their confirmed Chapter 11. Given this, there is still risk the customer may exit Chapter 11, yet default to vendors' post-confirmation credit sales.

F. Consider Impact of Bankruptcy Reform Act When Selling To A Chapter 11 Debtor

Given the changes to the Bankruptcy Reform Act that prefer certain creditors, vendors need to be especially vigilant with their postpetition credit analysis that a Chapter 11 customer may end up with insufficient cash and assets to meet its administrative expenses. In this setting, a vendor's credit sale, and resulting administrative claim, may go unpaid. While the vendor still has opportunities for continued sales with its customer that files Chapter 11, it does required a heightened awareness of the new credit risks.

USING AN ARBITRATION CLAUSE CONTAINED IN YOUR CREDIT APPLICATION TO COLLECT (PROMPTLY) ON YOUR DELINQUENT ACCOUNT

(Continued from page 4)

copies of emails between you and the customer. The arbitrator will accept all relevant evidence presented at the hearing, but not after the hearing. At the arbitration, you will be able to ask questions of your customer.

D. Mediation

Arbitration and mediation are similar in that they attempt to resolve disputes with customers without the vendor filing a lawsuit. Mediation is an informal process where the vendor and the customer select a mediator who attempts to bring the parties to a resolution through negotiation. If one party is not happy with the negotiations, they can terminate the mediation and pursue their claim in court.

E. Conclusion

A well crafted credit application that includes a binding arbitration clause may encourage the customer to pay disputed invoices rather than risk facing a prompt judgment through arbitration.

KEEPING THE CREDIT AND FINANCIAL PROFESSIONAL
INFORMED OF LEGAL DEVELOPMENTS
VISIT OUR WEBSITE @
www.bandblaw.com

The Trade Vendor Quarterly is distributed via E-Mail. ***The Trade Vendor Quarterly*** is a free publication prepared by the law firm of Blakeley & Blakeley LLP for clients and friends in the commercial credit and financial community. Please complete the following:

Representative to Receive Newsletter: ______________________________

Company Name: ______________________________

E-Mail Address: ______________________________

Telephone: ______________________________

Facsimile: ______________________________

Mailing Address: ______________________________

____

____

Others to Receive Newsletter: ______________________________

____

Please forward the information via:

E-mail: administrator@bandblaw.com

Fax: 949/260-0613

Mail: Ms. Karen Sherwood
Blakeley & Blakeley LLP
Wells Fargo Tower
2030 Main Street, Suite 210
Irvine, CA 92614
Direct Line: 949/260-0612