Blakeley & Blakeley LLP

# THE TRADE VENDOR QUARTERLY

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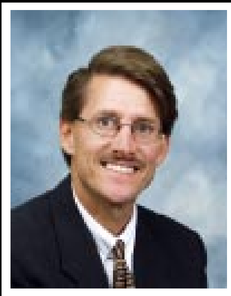
*Developments in Commercial, Creditors' Rights, E-Commerce and Bankruptcy Law of Interest to the Credit and Financial Professional*

## *PRIVACY LEGISLATION AND REGULATION AFFECTING THE CREDIT PROFESSIONAL*

## *YOUR CUSTOMER'S PRIVACY RIGHTS: WHOSE FINANCIAL INFORMATION IS IT ANYWAY?*

***Scott Blakeley***
sblakeley@bandblaw.com



With the arrival of the Internet and sharing of a customer's financial information electronically, a customer's privacy rights to financial information is now at the forefront of legislation passed, and pending, by the U.S. Congress and state legislatures. The Federal Trade Commission, the federal agency that regulates federal privacy legislation, is active in interpreting this legislation and is concerned with the unauthorized release of private credit information to third parties, includ-

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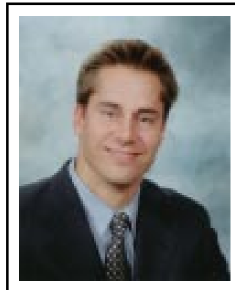
## THE ELECTRONIC CREDIT DEPARTMENT

## *PUBLIC ACCESS TO COURT ELECTRONIC RECORDS PROVIDES FOR IMMEDIATE INFORMATION OF STATUS OF PROBLEM ACCOUNTS*

***Bradley Blakeley***
bblakeley@bandblaw.com



The days of exorbitant courier service fees may soon be gone. PACER, Public Access to Court Electronic Records, an electronic public access service that allows users to obtain case and docket information from Federal Appellate, District and Bankruptcy courts, and from the U.S. Party/Case Index is quickly reducing the need for courier services. PACER is a service of United States Judiciary and is run by the Administrative Office of the United States Courts. Currently most Federal courts are available on the Internet. Other courts, including the Bankruptcy Courts for the Central District of California, must be dialed directly using communication software such as pcAnywhere or Hyperterminal via modem. Access to State Court records is not offered through PACER and the information, usually very limited, is typically accessed through each particular County's website.

PACER services are available to any individual with a personal computer and a modem. The PACER system permits you to request information about a particular individual or case and offers users electronic access to case dockets to retrieve information such as a listing of all parties and their representatives in a particular case including judge, attorneys, and trustees. Further, a compilation of case related information such as cause of action and amount in controversy are also available. Most importantly, the docket of the case is nearly always available and, in many courts, the actual document, imaged by the court, is available to be downloaded and saved. Other important information, such as a claims register, is also available, all within a few clicks of a mouse.

Currently 187 courts, consisting of 205 databases, offer electronic public access services through the PACER Service Center. The 187 courts consist of 9 appellate, 89 district, 89 bankruptcy courts and the Court of Federal Claims. If you do not know the particular case name or number, searches can be made using the U.S. Party/Case Index, which is a national index for U.S. district, bankruptcy, and appellate courts. Pleadings related to each bankruptcy case are transferred each night to U.S. Party/Case Index. Once you determine the case name or number, detailed information on the case may be found by dialing into the PACER system for the particular jurisdiction where the case is located.

Each federal court maintains its own databases with case information. Because PACER database systems are maintained

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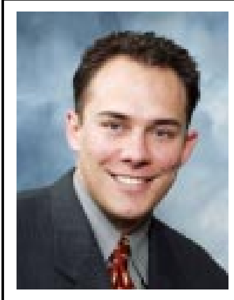
# EXECUTORY PRIVILEGE: PREFERENCE PAYMENTS AND THE UNTOUCHABLES

*Richard Ruszat*
rruszat@bandblaw.com



As many vendors are aware, perhaps the most disappointing aspect of bankruptcy law is being slapped with a preference lawsuit. Often times, vendors find it difficult to get paid at all, let alone receive a payment, and then defend it in a costly preference action. Moreover, a preference action seeks a dollar for dollar *return* to the estate whereas a vendor only receives a pro rata *distribution* under bankruptcy.

Accordingly, many of these vendors will defend the action with one of several codified exceptions to the preference action; others will control their destiny and reach settlement on terms that may be more favorable than treatment under a plan. However, certain vendors will keep their preference payment in their pockets despite the efforts for recovery of the payment by a preference plaintiff. These vendors are the "Untouchables."

The Untouchables are vendors that hold executory contracts and unexpired leases (hereinafter "executory contracts"). An executory contract is a contract under which the obligation of both the bankrupt and contracting party is so far underperformed that the failure of either to complete performance would constitute a material breach, and thus, excuse the performance of the other.

As a matter of law, transfers made during the preference period are not recoverable if the payments were made pursuant to an executory contract that was assumed by the trustee.[1] This conclusion finds support in case law and the application of section 547 and 365 of the Bankruptcy Code (the "Code"). Therefore, it is essential for these vendors to demonstrate the importance of their executory contract and convince the trustee that assumption of the contract will further its efforts to reorganize.

### *Recovering Transfers During The Preference Period*

The requirements of section 547(b) are designed to encourage an equitable distribution among similarly situated vendors.[2] Accordingly, section 547(b) provides that a trustee may avoid any transfer in property of the debtor if the transfer meets five requirements.[3] The preference period is 90 days prior to the filing of the petition, but may extend to one year if the transferee is an insider.

If the trustee satisfies the requirements of section 547(b), then the transfer is recoverable unless the transferee can prove that an exception is available. Generally, the exceptions are codified, however, many vendors are surprised to learn that exceptions are also generated from the interaction of certain Code provisions.

### *Curing Defaults As A Prerequisite To Assuming An Executory Contract*

The purpose of section 365 is to allow a

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**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. 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 of Blakeley & Blakeley LLP, Wells Fargo Tower, 2030 Main Street, Suite 540, Irvine, CA 92614. Phone: 949-260-0611 or Fax 949-260-0613 or Home Savings Bank Tower, 660 South Figueroa Street, Suite 1840 Los Angeles, California 90017 Telephone: (213) 385-5815 Facsimile: (213) 385-5817.*

*Copies of The Trade Vendor Quarterly are available by contacting Scott Blakeley at the above address or phone. He can also be reached at his e-mail address as follows:*

*sblakeley@bandblaw.com*

*or the firm's web site at www.bandblaw.com*

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

*Guest Column*

# THE E-VOLUTION OF CREDIT MANAGEMENT

*Dorman Wood, CCE*

**In June, 1896 at Toledo, Ohio, eighty-two delegates representing several local credit groups met to endorse a national movement for the exchange of credit information. Thus, was born the National Association of Credit Management (NACM).**

Since that milestone meeting over one hundred-four years ago, our profession has experienced and endured many changes. During my thirty years as an active credit professional, I have been witness to and involved in some of these changes. (And, despite some rumors, I was not present at the meeting in June, 1896.)

The first major change in which I was involved was the improvement in the relationship between credit and sales. Historically, the relationship between these two vital departments had always been adversarial, at best. Credit departments were run under the "command and control" concept. What limited communication existed between departments consisted primarily of credit telling sales which orders or accounts were on hold or being denied outright. I'm sure some of you can recall heated discussions within your own organizations and being tagged with names such as "order killer," "the order cancellation department," or "sales prevention department" to name a few which can be printed. Fortunately, during mid-to-late '70's, the relationship e-volved into one of mutual respect and cooperation. But, not without a great deal of effort from both parties. Also instrumental in the e-volution were the educational programs sponsored by NACM and its member Affiliates, at which many credit professionals learned how to work with "those sales people."

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# GUARDING YOUR SALES TO THE DOT-COM WITH CREDIT ENHANCEMENTS AND ALTERNATIVE PAYMENT MECHANISMS: DON'T LET YOUR INVENTORY END UP ON A DOT-COM LIQUIDATORS WEB SITE!

*Scott Blakeley*
sblakeley@bandblaw.com

Liquidation is a growth industry for dot-coms and the vultures of the Internet are arriving. A number of dot-coms now specialize in buying a failed dot-com's inventory at a steep discount and reselling the goods on the Internet. Bankruptcy trustees, too, have been buoyed by the dot-com bust as they auction off the dot-coms' remains over the Internet. Vendors have learned a painful lesson that there are few assets to pay vendors from an insolvent dot-com. Given the recent volatility of dot-coms, a credit professional must now consider alternatives to a credit sale to the dot-com. But the credit professional also appreciates that demanding a cash sale may mean losing business, perhaps significant business, as B2B and the Internet evolves. What credit enhancements or alternative payment mechanisms are available to protect the vendor in the event that the dot-com fails to pay?

## *Looking For Guaranteed Payment*

The vendor is looking for the credit enhancement that is most readily converted into cash, and is unlikely to be affected by an out-of-court liquidation or bankruptcy of the dot-com.

### Letter of Credit

A letter of credit (L/C) is a promise by an issuer, the bank, to pay the vendor, as beneficiary, when the dot-com has defaulted on the sale. The dot-com uses its assets as collateral for the L/C, so that the credit of the bank is substituted for the credit of the dot-com in favor of the vendor. The dot-com pays the issuing bank a fee to issue the L/C. If the vendor submits proper documents upon default, the bank will pay the L/C and the dot-com reimburses the bank. An L/C may be either revocable or irrevocable. An irrevocable L/C can be modified only with consent of the vendor. A revocable L/C can be modified by the bank without the consent of the vendor. The vendor can obtain a standby L/C, which assures payment after the dot-com's default. The vendor should insist on an irrevocable L/C with the dot-com sale.

L/C's are independent from the underlying contract between the dot-com and the vendor. The bank honoring the L/C is concerned only to see that the documents conform with the requirements in the L/C. If the documents conform, the bank will pay, and obtain reimbursement from the dot-com. The bank need not look past the documents to examine the underlying sale of goods. Thus, a vendor is given protections that the issuing bank must honor its demand for payment (which complies with the terms of the L/C), regardless of whether the goods conform to the underlying sale contract. The amount of the L/C should equal the amount of the line of credit.

The L/C's independence of contracts may allow a vendor to avoid the effects of a dot-com's bankruptcy. Bankruptcy courts recognize that the proceeds of a letter of credit are not property of the dot-com's bankruptcy estate, and that a bankruptcy court does not have authority to bar payment under a L/C, notwithstanding the effects of the automatic stay.

The vendor may insist on an L/C that provides for the maximum exposure under the credit line. For example, if the vendor specially manufactures goods, those goods that are in process yet not billed to the dot-com should be included in the amount of the L/C.

### Certificate of Deposit

A CD may be issued by the dot-com's bank in the name of the vendor. The CD is unconditionally payable to the vendor upon demand, is funded by the dot-com, and automatically renews for the length of the credit line. The principal amount accrues to the benefit of the vendor, and interest is paid to the dot-com.

### Credit Insurance

A vendor purchases credit insurance (CI) to avoid loss on a speculative customer, but keeps the accounts receivable. CI may cover a variety of credit risk, from a dot-com's bankruptcy, a default or dispute. The CI generally covers up to 90% of the insured account. The risk premium for CI may be measured by the vendor's accounts receivable risk profile. The credit insurer may monitor the buyer's financial condition. The term of the policy may be one year.

### Bankruptcy Swap

Like credit insurance, a vendor may purchase a bankruptcy swap to reduce credit risk but keep the account receivable on the books, unlike factoring where the account may be sold. A swap involves a third party that investigates the credit quality of the buyer of goods. Swaps are common with commercial banks and investment banks that look to diversify their credit risk. The vendor pays a periodic fee for the swap. Unlike credit insurance, the swap can be sold over the market. The buyer of the swap pays the vendor only in the event the dot-com files bankruptcy. The swap provides the vendor some protection against a dot-com's bankruptcy.

### Factoring

Factoring provides for the vendor to sell its dot-com account receivable at a discount to a third party, the factor, who is usually a financial institution. The sale is often non-recourse, which means that the factor is responsible for the dot-com account in the event of default. The vendor usually invoices the dot-com but is payable to the factor's address. The vendor sends the invoice to the factor, who pays a discounted amount of the invoice.

### Guarantee

A guarantee, whether corporate or per-

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# COUNTEROFFER DOES NOT REQUIRE WRITTEN NOTIFICATION UNDER THE EQUAL CREDIT OPPORTUNITY ACT, COURT RULES

*Scott Blakeley*
sblakeley@bandblaw.com

You receive an e-mail from a new customer requesting $50,000 of goods, with payment in 30 days. After your credit analysis, you agree to a sale of $25,000, with 15 day credit terms. The customer accepts your counteroffer. The Equal Credit Opportunity Act (ECOA) requires that a credit professional which takes "adverse action" (Adverse Action) on a credit application to give written notification to the applicant explaining the credit denial. However, ECOA does not define Adverse Action. Given this, do all refusals of credit as requested by the applicant constitute Adverse Action requiring written notice?

In today's commercial credit environment where the credit professional works with the sales department to make the sale, if the applicant accepts a counter offer for credit from the vendor, does this constitute an Adverse Action that requires written notification? The District Court for the Eastern District of Virginia recently concluded that not all actions taken by a creditor are Adverse Actions that require written notice of the reasons for the denial of credit; a counteroffer by the creditor and acceptance is one example of an action that does not constitute an Adverse Action.

### *What Is ECOA?*

ECOA was enacted by Congress in 1989, and the Federal Reserve Board issued Regulation B to implement ECOA in 1990. ECOA is a federal statute that prohibits credit grantors from discriminating in the granting of credit based on a prohibited basis, including race, color, religion, national origin, gender, marital status or age (collectively referred to under the regulations governing ECOA as the "Prohibited Basis").

As ECOA is a federal statute, it applies to all states. ECOA is intended to promote the availability of credit without regard to characteristics that have nothing to do with creditworthiness. Creditors are required to notify applicants of action taken on their applications, and to retain records of credit applications.

ECOA's prohibitions against discrimination are aimed primarily at the evaluation of a credit application by a credit grantor. The general rule is that a credit grantor can consider any information it obtains in evaluating whether to extend credit so long as the information is not used to discriminate against an applicant on a prohibited basis.

### *Court Rules That A Counteroffer Does Not Require Written Notification*

The facts supporting the District Court's opinion is that the applicant requested credit. The creditor counter-offered. The applicant accepted, but was not provided written notice of the reasons for being denied originally. The applicant sued the creditor.

The court ruled that a creditor's denial of a credit application that is coupled with a counteroffer that the applicant accepts does not constitute an Adverse Action that requires a written notice and explanation.

The court analyzed the ECOA statute, claiming that Adverse Action is a broad term, but then turns to the Regulations to determine that "adverse" is narrower and excluded are denials of credit that are coupled with counteroffers and accepted. The court noted:

> "Notice is an integral part of the ECOA scheme to prevent discrimination 'with respect to any aspect of a credit transaction'. . . ECOA and the implementing regulations mandate that a creditor 'notify the applicant of its action on the application,' within thirty days after receiving a completed credit application, and provide that '[e]ach applicant against whom adverse action is taken' is entitled to written notification. . . ECOA's written notice requirement is triggered only in the event a creditor takes 'adverse action' with respect to an application for credit. This follows from the fact that ECOA's plain language reqires notice for 'adverse actions,' but is otherwise silent as to other types of action—namely, 'approval[s] of [and] counteroffer[s] to applications for credit'. . . It is clear, therefore, that the regulations exclude from the definition of 'adverse action' any credit denials that are coupled with 'counteroffers' – or a 'grant [of] credit in a different amount or on other terms' – and, by logical extension, such denials coupled with counteroffers are also excluded from ECOA's written-notice requirements."

Had the applicant rejected the creditor's counteroffer, the creditor would have had to give written notice under ECOA.

### *Adverse Action Requires Written Notification*

Absent an accepted counteroffer, ECOA requires credit grantors provide written notification to applicants as follows.

### *Notice of Adverse Action Within 30 Days*

Under ECOA, a credit grantor must provide written notification to the applicant of Adverse Action within 30 days after a completed application is received by the credit grantor. The notification must provide that the applicant has the right to request reasons for the Adverse Action in writing within 60 days of such action. See Attachment A. Notification may be done verbally if the application was verbally made, otherwise it must be done in writing. ECOA provides that the notice of Adverse Action must contain language advising of ECOA similar to that in Attachment A.

### *Credit Applicant's Request For Statement Of Reasons Within 60 Days*

The applicant has 60 days from receipt of the credit grantor's Adverse Action letter to request an explanation of adverse ruling.

### *Credit Grantor's Statement Of Reasons Within 30 Days*

If an applicant requests an explanation of Adverse Action within 60 days, the credit grantor is to provide a statement of reasons within 30 days. The credit executive is not required to provide specific reasons for the Adverse Action, but instead may provide language such as, "adverse credit history"; "lack of business experience"; "lack of working capital"; or "too much secured debt." One form of letter addressing the

*(continued on page 7)*

***YOUR CUSTOMER'S PRIVACY RIGHTS: WHOSE FINANCIAL INFORMATION IS IT ANYWAY? (Continued)***

*(continued from page 1)*

ing the dramatic rise of the crime identity theft. Courts, including bankruptcy courts, have recently wrestled with the breadth of a customer's privacy rights and duties owed to customers.

Privacy groups and the press have made privacy rights a high profile topic. Indeed, according to a Wall Street Journal poll, Americans view loss of privacy rights as their greatest concern for the new century. Balancing the breadth of privacy rights and legislation is a difficult task, as information that is protected under privacy legislation means groups are denied access to financial information they believe they have a right to.

Credit professionals and their management must now consider whether to comply with new privacy legislation and audit their financial information gathering practices and disclose to customers how the information is shared. Compliance with the new privacy legislation is estimated to cost banks, insurance companies and finance companies billions of dollars. Big Five accounting firms and consulting firms now sell privacy audits to businesses to comply with privacy legislation and enforcement. With the arrival of new privacy legislation, it is expected that class action attorneys will gear up with private cause of action claims against businesses for tortuous invasion of privacy claims and negligence claims for failure to keep a customer's private financial information secure.

The essence of recent privacy legislation is to protect a party from the unauthorized release of private financial information to third parties. This means that there must now be disclosure by financial institutions to certain customers of their privacy policy, which includes disclosing that they collect financial information about the customer, that their financial information is shared with third parties, and that the customer may opt out of the sharing of the financial information.

What kind of business must comply with the new privacy legislation? Does Gramm-Leach-Bliley Act, also known as the Financial Services Modernization Act ("GLB") apply to a vendor extending commercial credit? What kind of customers may be protected under this privacy legislation? Are corporations and LLC's protected under the privacy legislation? What of sole proprietors? What kind of financial information is subject to the privacy legislation? Does private information include information publicly available? How does the privacy legislation affect the credit professional gathering and exchanging customer information with other credit professionals? What steps should the credit professional consider taking to comply with the legislation, especially with the threat of litigation?

Recently enacted privacy legislation, including the GLB, is intended to protect the unauthorized release of private financial information to third parties. However, in a rush to protect privacy rights, the U.S. Congress has enacted broadly worded legislation that attempts to protect financial information but may have the unintended consequence of impeding the sharing of certain account information as well as collection of commercial debts. The breadth of the new privacy legislation is starting to be tested in the courts.

***I. Gramm-Leach-Bliley Act of 1999/ The Financial Services Modernization Act/Title V***

**A. Purpose**

GLB repeals the Glass-Steagall Act that separated commercial banking from other businesses. Under Title V of GLB, extensive privacy protections and restrictions are imposed on disclosure of information about certain customers. It also requires that safeguards are in place to protect a customer's private information.

GLB is a federal statute that applies to all states. States may adopt their own privacy legislation that imposes even greater privacy protections. GLB's focus is on protecting the financial information of the consumer. But what is a "consumer" under GLB? Does GLB limit an individual's information to that relating to transactions for personal, family or household purposes? Does GLB protect the private financial information of sole proprietors, general partners or individual guarantors of business debt?

**B. Key Terms of GLB**

To consider whether GLB applies to a vendor extending commercial credit, an examination of the key terms of GLB is considered. The inquiries are: (1) is a vendor a "financial institution" under GLB?; if so, (2) what kind of customer is protected under GLB?; if a customer includes a party that obtains commercial credit, then (3) what kind of information is protected under GLB?; and, finally, (4) what are the steps to comply with GLB?

**1. What is a Financial Institution?**

GLB broadly defines "financial institution" as:

> "any institution engaged in the business of providing financial services to customers who maintain a credit . . . relationship with the institution."

GLB clearly applies to banks, insurance companies and securities dealers. GLB also appears to apply to finance companies and mortgage companies. Is a vendor extending trade credit engaging in the business of providing financial services under GLB? According to rules set forth by the FTC, a business entity that is not a traditional financial institution, such as a bank, must be "significantly engaged" in financial activities before GLB applies. An argument can be made that a vendor regularly extending trade credit may be significantly engaged in financial activities.

In a recent court test that considered the breadth of the definition of Financial Institution, Trans Union credit reporting service sued the FTC contending it is not a Financial Institution under GLB. The federal court rejected Trans Union's claim, giving the FTC discretion to broadly interpret GLB's statutory definitions.

**2. What is a Customer Relationship?**

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***GUARDING YOUR SALES TO THE DOT-COM WITH CREDIT ENHANCEMENTS AND ALTERNATIVE PAYMENT MECHANISMS: DON'T LET YOUR INVENTORY END UP ON A DOT-COM LIQUIDATORS WEB SITE! (Continued)***

*(continued from page 3)*

sonal, is not the preferred credit enhancement, as it requires the vendor to take legal action to get paid when the dot-com fails to pay. However, a guarantee may be used as leverage by the vendor to force the dot-com to pay by threatening to pursue the guarantor, who may be a principal of the dot-com. Dot-coms are often financed by deep-pocketed venture capitalists. If the vendor is a key supplier of the dot-com, the vendor may look to the venture capitalist to guarantee the sale.

The basic legal principle is that the guarantor is not a party to the principal debt. The guarantor's undertaking is independent of the dot-com's promise to pay. Merely because both contracts are on the same paper, for example, the credit application — the dot-com's promise to pay for the vendor's goods or services, and the guarantor's promise to pay if the dot-com does not — does not change the independence of the agreements.

The guarantee should include a statement that the signing party is personally guarantying the debt of the dot-com referenced in the credit application. The guarantee should have under the signature block a line for the individual guarantor's social security number and a line for the individual guarantor's home address. The guarantee should be signed before a notary to reduce the risk that the guarantor may contend that the guarantee was forged.

**Purchase Money Security Interest**

The vendor may consider taking a security interest in the goods it sells to the dot-com, and the proceeds from the sale of the goods. Under the amended Article 9 of the Uniform Commercial Code, for the vendor to obtain a valid purchase money security interest (PMSI) in the goods it sells to the dot-com a multi-step process must be complied with. The dot-com first executes a security agreement describing the goods covered in favor of the vendor, which gives the vendor a security interest in those goods. The vendor perfects the security interest when it files a financing statement with the filing office (usually the Secretary of State), which adequately describes the goods.

The vendor's PMSI will prime the inventory secured creditor's lien only if: (1) the PMSI is already perfected at the time the dot-com receives possession of the goods; and (2) the vendor gives written notice to any other preexisting inventory secured creditor. If the vendor fails to perfect the PMSI, including giving notice, the vendor's priority is governed by the "first to file" rule. This means that an inventory secured creditor will prime the vendor's PMSI.

Some problems with a PMSI can be that it requires the consent of the dot-com, may require the consent of the dot-com's lender, can be complicated to properly perfect and can be cumbersome for the vendor frequently selling in small lots.

**Consignment**

Article 9 of the UCC's perfection requirements provides the means whereby a vendor can establish a valid security interest in its own inventory, even when that inventory has been delivered to the dot-com. The vendor's compliance with the perfection requirements of the UCC not only protects ownership of inventory; in the event of a dispute over the goods, the vendor will prevail over a competing creditor.

An agreement is executed describing the relationship of the parties involved (i.e., the vendor owner is consignor and the dot-com seller is consignee); a description of the inventory; and agreement that title to the merchandise only passes to third-party buyers. Then the vendor completes a UCC-1 financing statement, which again describes the inventory and makes clear that the inventory is delivered on consignment. The vendor then files the statement with the filing office (usually the Secretary of State).

A vendor must give notice to any creditor asserting a security interest in the dot-com's inventory in order to avoid any appearance that inventory coming to the dot-com is free from ownership claims. To have priority in the accounts receivable generated by the sale of consigned goods, the vendor must also comply with the UCC notice-filing requirements as to accounts receivable.

Like PMSI, some problems with a consignment can be that it requires the consent of the dot-com, can be complicated for the vendor to properly perfect and can be cumbersome for the vendor frequently selling in small lots.

***Alternative Payment Mechanisms When Dot-Com Cannot Furnish Credit Enhancement***

The dot-com and the Internet are not only changing the way vendors bring their goods to market, but also they are changing the way in which vendors may be paid on their sale. A vendor may turn to credit cards and e-payments where a credit enhancement is unavailable or not workable.

**Credit Card**

Payment by credit card is appealing to the vendor as it allows for payment prior to goods being released to the dot-com. However, a vendor may risk chargeback of disputed balances. The dot-com's credit card company is not obligated to verify whether the dispute is legitimate. The vendor may also be responsible for unauthorized purchases and fraud. A vendor may accept a personal credit card for a commercial sale; however, it may be an indicator that the company the person is purchasing for is in financial trouble. However, it may mean that the person wants the frequent flyer miles. Credit card transactions conducted by telephone, fax or the Internet, also known as card-not-present transactions, have a higher risk of fraud.

**E-Checks**

An E-check is an electronic version of a paper check. The e-check may provide for multiple payers, endorser signatures and is governed by the UCC covering checks. The vendor may chose to have a third party accept the payments in an e-lockbox or have the receipt directed to the accounts receivable department for handling. E-

*(continued on page 7)*

***GUARDING YOUR SALES TO THE DOT-COM WITH CREDIT ENHANCEMENTS AND ALTERNATIVE PAYMENT MECHANISMS: DON'T LET YOUR INVENTORY END UP ON A DOT-COM LIQUIDATORS WEB SITE! (Continued)***

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checks use digital signatures where federal legislation recently recognized their use.

**CheckSpace**

CheckSpace enables the vendor to send invoices and receive payments from the dot-com electronically. The service provides for B2B payments between the vendor and the dot-com with e-mail addresses and bank accounts. The service also provides for online accounting with a listing of payables and receivables as well as a check register for payments made online.

***Credit Enhancements Or E-Payments Can Make The Dot-Com Sale***

Credit professionals are in the business of "making the sale." The key to a credit enhancement is to structure the instrument so that the vendor will realize the maximum recovery upon a dot-com's liquidation or bankruptcy. By choosing credit enhancements or alternative payment mechanisms the credit professional can maximize the sale and minimize the risk.

***COUNTEROFFER DOES NOT REQUIRE WRITTEN NOTIFICATION UNDER THE EQUAL CREDIT OPPORTUNITY ACT, COURT RULES (Continued)***

(continued from page 4)

statement of reasons letter is provided as Attachment B.

***Conclusion***

The court held that a rejection of the application for credit coupled with a counteroffer which the applicant accepts does not constitute an Adverse Action, and, thus, the creditor does not have to give notice to the applicant under ECOA.

ATTACHMENTS "A" – "B"

NOTIFICATION OF ADVERSE ACTION

[Date]

[Name of Business
Address
City, State & Zip Code]

Thank you for applying to us for unsecured credit. We cannot extend credit at this time.

If you would like a statement of reasons why credit was denied, please contact [credit executive], within 60 days of the date of this letter, at the following address. We will provide a statement of reasons within 30 days after receiving your request.

[Company Name and Address]

The Equal Credit Opportunity Act (ECOA) prohibits a credit grantor from discriminating against a credit applicant on the basis of race, color, religion, national origin, sex, marital status or age. The Federal Trade Commission administers compliance with ECOA.

Very Truly Yours,

[Credit Executive]

ATTACHMENT "A"

STATEMENT OF REASONS

[Date]

[Name of Business
Address
City, State & Zip Code]

In response to your letter requesting a statement of reasons why your request for credit was denied, we find that your [adverse credit history][lack of business experience][lack of working capital][excessive secured debt] prevents us from extending credit at this time. The Equal Credit Opportunity Act (ECOA) prohibits a credit grantor from discriminating against a credit applicant on the basis of race, color, religion, national origin, sex, marital status or age. The Federal Trade Commission administers compliance with ECOA.

Very Truly Yours,

[Credit Executive]

ATTACHMENT "B"

***THE E-VOLUTION OF CREDIT MANAGEMENT (Continued)***

*(continued from page 2)*

Another e-volution that took place within the credit profession occurred in the mid-to-late 70's: hardware and software became available that enabled credit departments to complete overnight "batch" processing and the ability to see the results of the previous day's activities. Invoices could be generated and mailed to customers the day following product shipment; account activities and accounts receivable aging reports became available to management. "Smart terminals" enabled remote offices to transmit data to a corporate main-frame computer for overnight processing with the results returned within a 6-8 hour period. These developments enabled credit professionals to reduce their DSO, past due accounts receivable, bad debt losses and to effectively manage customer credit limits.

Communication improvements continued with the mass production and availability of the facsimile machine. Although the "fax" was invented in the early 1920's, the technology was not used commercially until 1948 when Western Union introduced its "desk-fax" service. Some 50,000 units were built and used between 1948 and 1960 when the service was discontinued. Although there were many different manufacturers of fax machines in the mid-to-late 60's, it wasn't until 1974 that an international standard was adopted which permitted American fax machines to "talk" with those in Europe. I am sure many of you can recall the early days of dealing with "thermal fax paper" which curled up at the edges and whose images faded into oblivion after a few weeks of being received. While the fax machine was useful tool for credit professionals, it had one major draw-back; unless the person to whom you wished to fax a message or documents had one, you had to resort to what we now call snail mail.

Personal computers were probably the next major e-volution that credit professionals experienced. The invention of the personal computer is attributed to Ed Roberts, founder of MITS, Micro Instrumentation Telemetry Systems. In 1974, Ed Roberts introduced his first machine, a kit for hobbyists, which included an Intel 8080 microprocessor, a 256 byte RAM card and a panel of switches. The price: $395. Microsoft founders Bill Gates and Paul Allen would later work for MITS for awhile before going off to earn their fortunes. As personal computers gained popularity within the business community, credit professionals began using a new tool, which would change many of their lives, forever. Personal or desk-top computers have given the credit professional the ability to interface with legacy or main-frame computer systems, from which they can extract needed information upon demand. This information can then be "sliced and diced" in many different ways and used to communicate the status collections, accounts receivable balances, DSO etc..

Just when most credit professionals were getting comfortable with their personal computers, along comes the World Wide Web, or the Internet. The phenomenon of the "net" has turned the business world upside down for many credit professionals and their employers. Companies who previously were doing business on a regional or national basis now have a world wide customer base. And, many lack the in-house expertise to transact international business. They are unfamiliar with export regulations and international shipping; international terms of sales (INCOTERMS); international collections; in-country laws and/or taxation, and their policies and procedures are suddenly inadequate.

The birth of E-Commerce has spawned new terminology. "Old economy" and "New Economy" are two of those heard most frequently. The "New Economy" has brought us customer demands for faster product availability – from fewer sources, faster service or information delivery and, all at a lower cost. The consumer is now the purchasing agent who is buying for his or her company via the "Net." They want the same "real time" service: online catalog, product availability, selection of shipping and payment method; order and shipment confirmation, shipment tracking, invoice selection and payment.

Credit professionals are challenged to keep up with the demands of doing business at "Net speed" by automating as much of their "Old economy" credit process as possible. Online credit applications have become common place on business web sites. Behind the credit application, more and more firms are putting credit decision making, or "scoring" software into place. Such software extracts the information supplied via the credit application, processes it against the macros or bench marks built into the scoring software and renders a "credit decision" within a matter of 2-5 seconds.

Another challenge for the credit professional that has been created by the "New Economy" is dealing with "start-ups." The Internet created many new companies that were formed specifically to conduct commerce via the "Net." For the most part, these companies have been funded by Venture Capitalists (VCs). Many VCs have made (and in some cases lost) fortunes through staking the start-ups, backed by an equity position. If the start-up is successful and survives beyond the IPO (Initial Public Offering) stage, the VCs may see a huge return on their investments. The difficulty for the credit professional is trying to use "tried and true" methods of analyzing the credit worthiness of the start-ups. While the typical start-up is cash rich, it ordinarily will have few, if any other assets. The credit professional then must determine such information as: the start-up's "burn rate" – how much cash does it take for them to operate each month, how many months supply do they have; what round of funding they are in – 1st, 2nd or 3rd; when is their next round of funding; who are their VCs – what is their track record; what is their window of opportunity for bringing their product or service to market; who is their competition – what share of the marketplace do they hold; what makes their product unique compared to competitors; what is the track record of the company's founders – what company(ies) have they successfully run in the past; and what is their business plan – when does it show the company turning a profit?

Doing business via the "Net" or within the "New Economy" has raised some interesting, if not thorny legal issues with which the credit professional must deal. A few of these issues are: collections by e-mail; exchange of confidential information via e-mail; negotiation of terms via e-mail; use of

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***THE E-VOLUTION OF CREDIT MANAGEMENT (Continued)***

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an electronic or encrypted signature for credit applications and/or contracts; billings online; online payment via credit card, debit card; and payment by fax-check.

For many credit professionals, the challenge of dealing with customers within the "New Economy" can be overwhelming. Unfortunately, many credit professionals around the country have awakened to the fact that they are already behind the learning curve. I recently spoke with two credit professionals for whom I have a great deal of respect and asked them for some sage words of advise for those of us toiling within the "New Economy" credit community:

Mike Meerman, CCE, Executive Director, Creditors Service Corp. (a former working credit executive): "I really don't have a clear and communicable vision for the professions direction, but do emphasize to everyone the absolute need to anticipate, plan for, and accommodate the unknown. You see, the trouble with the future is that it usually arrives before we are ready for it!"

Don Mosher, CAE, CCE, Chief Operating Officer, NACM-North Central (a former working credit executive): "The internet has made information much more liquid. Used efficiently, it will allow decisional information to be positioned at the point of sale to improve speeds and reduces friction (inconveniences) with 80-90 percent or more of the customers. Credit's future value proposition needs to give more focus to every company's goal of "getting customers and keeping them". Current credit managers need to recognize that the credit function has become horizontally integrated into the order to cash process. Hence they have to be more cross-functional and plan to spend much more of their time working on corporate teams to see how the function of credit impacts customers (both internally and externally). This will require both skills of high tech and high touch. It is not too late to get a head start on the behavioral skills training. Now let's see how many of us take the initiative to find out what those skills are versus getting more information on high tech."

Working within the new "New Economy" arena is exciting and challenging, if nothing else. The internet spawned commerce has been described as being much like that which grew out of the California gold rush. Between the time gold was discovered at Sutter's Mill in 1848 through 1852, an estimated $2 billion in gold was taken from the earth in the central portion of California's Eastern Sierra foothills known as the Mother Lode country. While that may seem like a tremendous amount of money for that era, consider that the first millionaires of the gold rush were not the miners, but the suppliers who provisioned the miners with tents, shovels, pick axes, clothing, bedding, food, liquor, etc.

Remember that we are only three years into the commercial use of the "Net." These are the "very early days" of a web-based business model; a model that will continue to be redefined. When you read or hear of another "dot.com" failure, check to see if the company's customers were consumers or other commercial businesses. The majority of all "dot.com" failures to date have been those who relied on consumer customers. These were not B2B, or business-to-business companies.

The gold miners were for the most part, unprepared for the challenges of digging for gold, while attempting to protect their claims. We credit professionals are similarly unprepared for the challenge of protecting our employer's investment in accounts receivable assets while conducting business within the "New Economy." However, by seeking new information through educational events, reading credit and financial periodicals, attending industry credit meetings and maintaining your credit professional network, you are taking the steps necessary to meet the challenge of the "New Economy." You are at the center of the "E-volution" of credit management. Plan for the unknown. The only thing certain about the future of our credit profession is change.

***YOUR CUSTOMER'S PRIVACY RIGHTS: WHOSE FINANCIAL INFORMATION IS IT ANYWAY? (Continued)***

*(continued from page 5)*

A Customer Relationship determines whether the Financial Institution must comply with privacy notice requirements of GLB. A Customer Relationship is defined as a continuing relationship between a Financial Institution and party under which the Financial Institution provides one or more products that are to be used primarily for personal purposes. <u>If a Financial Institution does not have a customer relationship</u>, then notice is required only where there is an intent to disclose nonpublic information to third parties.

The Federal Reserve and FDIC's commentary suggests that GLB does not apply to customers of a financial institution that are corporations or LLC's. The FTC's commentary also suggests that GLB does not apply to individuals, such as sole proprietors, when they obtain financial products for business or commercial purposes. Whether credit extended is for commercial purposes may be analyzed under the criteria set forth in Regulation Z and the Truth-in-Lending Act.

If a business is a Financial Institution under GLB and the customer is protected under GLB, the Financial Institution has a duty to protect the security of a customer's non-public personal information. A Financial Institution may not disclose non-public personal information to third parties unless an opt out notice is sent to the customer.

**3. What Information is Covered?**

GLB covers non-public personal information, which includes information resulting from a transaction with the customer. The FTC views any personally identifiable information provided to a Financial Institution, even if available from other public sources, covered by GLB.

An example of the broad interpretation of information protected under GLB, the Trans Union court ruled that credit bureaus are barred from selling "credit headers", which are a consumer's name, address and Social Security number, to marketers. Prior to GLB, "credit headers" were sold without consent. The FTC views "credit headers" as "financial information" under GLB Act and the Trans Union court agreed. Although the credit header does not include financial information about credit history or bank accounts, the FTC views that identifiable information provided to the FI, even if available from public sources, is covered by GLB.

**C. Notice Requirements**

GLB imposes notice to customers.

**1. Initial Notice**

GLB requires a Financial Institution to provide an initial notice to customers of their privacy policy, and if they will disclose personal information to third parties. The notice should state the institutions that the Financial Institution will disclose the information to. The initial notice should also state the security and confidentiality of a customer's personal information. Electronic notice to a customer is effective, provided the customer agrees.

**2. Annual Notice**

In addition to the initial notice requirement, a Financial Institution is required to provide an annual notice whether personal information is to be shared. As with the initial notice, electronic notice is effective, provided the customer agrees. The notice requirements of privacy policies are intended to allow potential customers the opportunity to review the privacy policy. Posting a notice on a Web site is acceptable if the customer agrees.

**3. Opt Out/Consent**

If the Financial Institution intends to share private information, it must provide a party with an opportunity to opt out. The opt out notice provides for consent by the customer to allow the Financial Institution to share information with third parties.

Certain state agencies are refusing to release information of sole proprietors. For example, the California State Board of Equalization refuses to release information of sole proprietors holding licenses or permits, absent consent from the sole proprietor.

**D. Complying with GLB**

If GLB applies, the following steps should be considered.

**1. Privacy Policy and Notices**

The credit professional should consider how customer information is collected and shared. The credit professional should have its company adopt a policy as to notification of customers, storing private information and sharing private information with third parties. The notice should also provide for customers to opt out of the sharing of information prior to disclosing to third parties. A customer list should be maintained listing those that receive initial and annual notices. Employee access should be limited to customers' private information and protect against threats to customers' records.

**2. Security**

In addition to privacy notices, GLB requires a customer's information is secure. Personal information should be protected by reasonable security safeguards against such risks as loss or unintended disclosure of customers' information.

**3. Written Manual**

The vendor should have a company policy manual advising of its privacy policy.

**4. Training**

Train credit and sales as to the privacy policy. GLB applies to agents of the company cloaked with authority to request information from applicant. Some companies have employed a Chief Privacy Officer or an information manager to comply with privacy policy.

**5. Credit Application**

The credit application should disclose the policy of gathering and sharing private information with third parties. A signature

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***YOUR CUSTOMER'S PRIVACY RIGHTS: WHOSE FINANCIAL INFORMATION IS IT ANYWAY? (Continued)***

*(continued from page 10)*

block may be added to the credit application to have the customer opt out of the sharing of information.

**6. Guarantee**

The personal or corporate guarantee should disclose the policy of gathering and sharing private information with third parties.

**7. Privacy Audit**

Big Five accounting firms and consulting firms have launched specialized units that sell privacy audits to comply with legislation. Consultants review a company's computer databases to determine how personal identifiable information is used.

**E. Violation of GLB Act**

GLB prohibits disclosure of information that is obtained from the customer by deception. GLB creates liability for anyone who obtains or discloses information, without knowledge of any inappropriate conduct. Liability is not limited to the party participating in the violation, but may extend through the chain of custody of the tainted information.

**1. Defense to Alleged Violation**

A possible defense to an alleged violation of GLB is the doctrine of corporate free speech. A vendor may contend that attempts to outlaw or restrict the sale or sharing of personal information and public records violates the First Amendment right to communicate with customers.

In the Trans Union case, Trans Union's right of corporate free speech in selling "credit header" information failed. The court ruled that the FTC's interest in protecting privacy rights under GLB outweighs Trans Union's First Amendment Rights of commercial speech.

**F. Regulation and Enforcement of GLB Act**

**1. Private Cause of Action**

GLB does not provide for standing for a private cause of action. However, it may be that private parties will be authorized to pursue claims under GLB. Traditionally, class action lawyers have pursued a claim for corporation invasion of privacy. However, prior to the enactment of GLB, privacy laws protected against invasions by the government, not by business. GLB may provide class action lawyers with a fresh approach to invasion of privacy claims.

Privacy watchdog groups have also formed, such as the Privacy Foundation, who investigate whether businesses are complying with privacy legislation.

**2. Public Enforcement**

The Federal Trade Commission enforces GLB on behalf of the government.

**3. Penalties and Liabilities**

GLB provides for punitive damages, attorneys' fees and costs. GLB also provides for criminal liability of up to five years.

***II. Bankruptcy Privacy Issues***

A customer's privacy rights in the context of a bankruptcy are also being considered by bankruptcy courts, the FTC, privacy groups and the U.S. Congress.

**A. Toysmart.com: Customer Lists and the Privacy Pledge Problem**

A dot-com's customer list may be its most valuable asset, as the customer list contains information concerning a customer's buying preferences, names and ages of children, credit card numbers, birth dates, and other information, which customers may not wish to disclose to third parties. For years, brick-and-mortar companies have sold their customer lists as assets in bankruptcy proceedings without objections by government agencies. However, due to the detailed nature of the customer list and the dot-com's privacy pledge, its treatment in an e-bankruptcy may bring conflicting interests with the FTC and State Attorneys General.

There is no federal privacy law that expressly prohibits a dot-com from selling its customer list, although the pending Bankruptcy Reform Act of 2001 proposes to address this. However, a dot-com may still encounter opposition from federal and state regulatory agencies in trying to sell its customer list, where privacy was promised by the dot-com when the customer information was collected.

The dot-com Toysmart.com generated controversy with its attempts to sell its customer list. Unable to pay its creditors, Toysmart filed Chapter 11. Toysmart solicited bids for its assets, which included its customer list, despite a posted privacy statement promising not to share such information. Toysmart's customer list comprised 250,000 customer names and related information, including addresses, shopping preferences, order history, billing information, credit card numbers, family profiles, including information about customers' children. Toysmart believed the customer list was worth millions of dollars. Toysmart pledged to its customers that information provided would be private in an effort to attract traffic to its website:

> *Privacy Guarantee*
>
> *[W]e take great pride in our relationships with our customers and pledge to maintain your privacy while visiting our site. Personal information voluntarily submitted by visitors to our site, such as name, address, billing information and shopping preferences, is never shared with a third party.*

Toysmart had its web site's privacy policy certified by the TRUSTe Privacy Seal Program. Under the privacy seal program, a customer can protect information by clicking on the seal.

Using its police powers, the FTC sued Toysmart for deceptive trade practice under Section 5 of the FTC Act, alleging that in attempting to sell its customer list, Toysmart was breaking its own posted privacy policy and violated fair trade practices, and that the bankruptcy court should

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***EXECUTORY PRIVILEGE: PREFERENCE PAYMENTS AND THE UNTOUCHABLES (CONTINUED)***

(continued from page 2)

trustee to reject burdensome executory contracts, while at the same time, provide the trustee with a mechanism to force others to continue to do business with the debtor during its reorganization.[4]

Accordingly, section 365(A) states that a trustee may assume an executory contract, provided that, "if there has been a default … the trustee may not assume such contract … unless, at the time of the assumption of such contract, the trustee … cures, or provides adequate assurance that the trustee will promptly cure, such default."[5]

If the court grants a trustee's assumption of the contract, the contracting party has no choice; continued performance is required under the terms of the contract.[6] However, if the debtor is delinquent under the executory contract, either pre-petition and/or post-petition, then the trustee must demonstrate to the court that he can cure the default and make future payments.

Accordingly, an assumption order distinguishes the contracting party from other vendors. The contracting party is forced to continue to do business with the debtor. However, in exchange, the contracting party is entitled to payment of all amounts due under the contract. In other words, the assumption effectively gives the contracting party a secured interest in monies due, and effectively, eliminates preference actions.

***Creating A Common Law Exception: To Cure or be Cured***

Viewed separately, section 547(b) and 365 appear mutually exclusive and do not pose any inconsistencies. However, the treatment of any transfers made during the preference period will depend on whether the trustee elects to assume or reject the contract. If the trustee assumes the contract pursuant to section 365, then section 547(b)(5), a requisite to recovery of a preferential transfer, will not be satisfied and no preference is deemed to have occurred.[7] It is common sense.

The requisite to assuming an executory contract is to cure the prepetition default, and the payments received during the preference period would have to be paid under a cure. If these payments were recoverable as a preference, then the trustee would have to re-pay the preference to assume the contract. The result is a wash.

As further protection against an enthusiastic trustee, the equities of assumption cannot be made in a preference action, but must be made in an action challenging the order that approved the assumption. Courts have applied the doctrine of estoppel to preclude the trustee from receiving the benefits of an assumed contract without also assuming its obligations.[8]

Additionally, the congressional intent behind section 365 is decisive; a party to an executory contract must be paid all amounts due under the contract before the contract may be assumed. In drafting section 365(b)(1), Congress ensured that a contracting party is made whole before a court can force the party to continue performing with a bankrupt debtor, "[i]f the trustee is to assume a contract … the court will have to insure that the trustee's performance under the contract … gives the other contracting party the full benefit of his bargain."[9]

By retaining prepetition payments, a party to an assumed contract does not receive more than other similarly situated vendors.[10] From the moment that the assumption order is entered, the contracting party's interest is necessarily distinct from the interests of unsecured vendors. Permitting a preference suit after an assumption order would undermine the purpose and intent of section 365. Accordingly, the assumption of an executory contract bars recovery of a preference claim.

***Seminal Cases***

In *Superior Toy*, the Seventh Circuit dismissed a preference action commenced against a party to an assumed contract.[11] The court ruled that the cure provisions of section 365 required the trustee to cure all pre-petition defaults prior to assuming the contract, and therefore, the payments during the preference period were not preferential. The court ruled that preference actions are prohibited against parties to an assumed executory contract because section 365(b) requires a trustee to cure all defaults of an assumed contract. The Seventh Circuit also concluded that the trustee was estopped from prevailing on the preference action as the trustee benefited under the assumed contract. *See Id.* at 1176.

In *In re LCO Enterprises I*, the Ninth Circuit considered whether a trustee is entitled to recapture prepetition lease payments as a preference where the trustee assumed the lease.[12] The court's inquiry was the appropriate classification of the vendor. In the ordinary case, general unsecured vendors claims are fixed at the date of the bankruptcy petition and preferential transfers are subject to recapture.

However, vendors holding executory contracts and unexpired leases stand in a different position relative to general unsecured vendors. Although the prepetition default may be fixed, the status to the right to payment from the estate is not fixed because it is dependent upon whether the trustee assumes or rejects the executory contract or unexpired lease. If the trustee assumes the contract pursuant to section 365, then section 547(b)(5), a requisite to recovery of a preferential transfer, will not be satisfied and no preference is deemed to have occurred.

After distinguishing the holders of general unsecured claims from those vendors that are parties to an executory contract or unexpired lease, the Ninth Circuit considered the application of the hypothetical chapter 7 case under section 547(b)(5). The Ninth Circuit aligned the interests of party to an assumed contract or lease with that of a secured vendor.

These vendors would be entitled to prepetition payment of their claims. Accordingly, the Ninth Circuit concluded that, taking the facts as they are at the time of the assumption, the holder of an assumed contract or unexpired lease is entitled to 100% of the claim. The preference action was dismissed.

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***EXECUTORY PRIVILEGE: PREFERENCE PAYMENTS AND THE UNTOUCHABLES (CONTINUED)***

*(continued from page 12)*

***Other Code Provisions***

In *Seidle*, the Eleventh Circuit considered whether a trustee is entitled to recapture prepetition contract payments when the parties entered into a court approved stipulation pursuant to section 1110.13 Under section 1110, a debtor may retain possession of equipment by curing defaults and making the required payments. The Eleventh Circuit concluded that a trustee is precluded as a matter of law from bringing a preference suit after the court approved the stipulation.

"A trustee's election to set aside alleged preferential payments would undermine the protection that section 1110 provides for vendors. Pursuant to the section 1110 stipulation, a vendor is entitled to unpaid prepetition payments, as defaults; a trustee may not later thwart the effect of the statute by challenging the validity of these transfers as preferences."14

***Conclusions***

If you are a vendor to an executory contract or unexpired lease, then carefully assess your situation. If you are exposed to a substantial preference action, then getting the trustee to assume your contract is key to eliminating your liability. The exchange, of course, is a continued relationship with the debtor throughout the term of the contract. However, if you are a vendor with an assumed contract that has already encountered a preference action, then do not give in to the trustee as you may be a member of the Untouchables.

[1] The court may require the consent of the contracting party when the trustee intends to assign the contract to a third party. *See In re Catapault Entertainment, Inc.*, 165 F.3d 747 (9th Cir. 1999)(holding that federal patent law constitutes "applicable law" within meaning of Bankruptcy Code provision barring debtor from assuming executory contract without nondebtor's consent where applicable law precludes assignment of contract to a third party).

[2] *See Matter of Smith*, 966 F.2d 1527, 1535 (7th Cir.) (citing H.R.Rep. No. 595, 95th Cong., 2nd Sess. 177-78 (1978); U.S.Code Cong. & Admin.News 1978 pp. 5787, 5963, 6137-6139).

[3] Under § 547 (b), a trustee or debtor may avoid any transfer of an interest of the debtor in property if the transfer is: (1) to or for the benefit of the vendor; (2) for or on account of an antecedent debt owed by the debtor before such transfer was made; (3) made while the debtor was insolvent; (4) made – (A) on or within 90 days before the date of the filing of the petition; or (B) between ninety days and one year before the date of the filing of the petition, if such vendor at the time of such transfer was an insider; and (5) that enables such vendor to receive more than such vendor would receive if –(A) the case were a case under chapter 7 of this title; (B) the transfer had not been made; and (C) such vendor received payment of such debt to the extent provided by the provisions of this title. See 11 U.S.C. § 547 (b).

[4] *See Frito-Lay, Inc. v. LTV Steel Co., Inc. (In re Chateaugay)*, 10 F.3d 944, 954-55 (2d Cir. 1993).

[5] *See* 11 U.S.C. § 365 (A).

[6] *See Richmond Leasing Co. v. Capital Bank, N.A.*, 762 F.2d 1303, 1310 (5th Cir.1985).

[7] Alternatively, if the contract is rejected, then the transfer is subject to a preference recovery if the remaining elements of §547(b) have been satisfied.

[8] *See In re Matter of Superior Toy & Mfg. Co., Inc., ("Superior Toy")*, 78 F.3d 1169, 1176 (7th Cir. 1996)

[9] *See* Senate Rep. No. 989, 95th Cong., 2nd Sess. 59 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5845; H.R.Rep. No. 595, 95th Cong., 2nd Sess. 348 (1978), reprinted in 1978 U.S.C.C.A.N. 5963, 6304-05.

[10] *See* Superior Toy, 78 F.3d at 1172.

[11] *See* 78 F.3d 1169.

[12] *Alvarado v. Walsh ("In re LCO Enterprises I")*, 12 F.3d 938 (9th Cir.1993)

[13] *See Seidle v. GATX Leasing Corp.*, 778 F.2d 659 (11th Cir.1985)

[14] *See Id.* at 662.

***YOUR CUSTOMER'S PRIVACY RIGHTS: WHOSE FINANCIAL INFORMATION IS IT ANYWAY? (Continued)***

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stop any sale of the customer list. 38 state attorney generals filed objections with the bankruptcy court also seeking to bar the sale of the list.

The FTC reached a settlement with Toysmart that allowed the company to sell its customer list, but only if the bidder complied with the same privacy policy. The creditors' committee of Toysmart objected to the settlement between Toysmart and the FTC, complaining that the settlement would chill bidding. The bankruptcy court refused to accept the deal, instead waiting to see if bidders surfaced. No company bid for the customer list. Toysmart was paid $50,000 by Disney to have its customer database destroyed rather than being sold off to pay creditors.

The privacy pledge issue recently was raised in the e-Toys Chapter 11 bankruptcy. eToys, an e-tailer, had made a privacy pledge to its customers that their personal information would remain confidential. eToys was unable to pay its obligations and filed Chapter 11. eToys proposed to sell all of its assets to a competitor, including its customer list. Several State Attorney Generals objected to the sale of the customer list complaining breach of privacy policy. In a settlement, eToys agreed that no customer information would go to its competitor without customer consent. An opt-in notice is sent to customers. eToys will not give credit card information to the competitor, even for those who opt-in.

The U.S. Congress is expected to pass federal legislation to protect a consumer's privacy rights on the Internet in the context of a privacy pledge. States have also stepped-up their interest in pursuing their own claims under state consumer protection laws. Several states have proposed laws concerning online privacy. Federal and state regulatory agencies do not believe that the Bankruptcy Code, as presently enacted, preempts their police powers to enjoin a dot-com from selling its customer list where it has made a privacy pledge.

In an attempt to avoid Toysmart's problems of blocking the sale of a customer list, some dot-com e-tailers have changed their privacy statement. Amazon now discloses:

> *In the unlikely event that Amazon.com, or substantially all of its assets are acquired, customer information will, of course, be one of the transferred assets.*

The new disclosure may allow a dot-com to sell its customer list should it fall into insolvency, given that the FTC and attorney generals' claims were based on Toysmart's alleged misrepresentations to its customers.

However, if the dot-com e-tailer has made a privacy pledge to its customers like in Toysmart, and attempts to sell its customer list through bankruptcy, the FTC and state and attorney general will likely attempt to bar the sale.

**B. Information on Bankruptcy Petitions**

The Bankruptcy Code requires individual debtors, including sole proprietors and guarantors of business debt, to provide sensitive information, including account numbers, social security numbers, tax returns, balances, income sources and payment histories. A national electronic database of bankruptcy information has been established with this detailed information to answer creditor inquiries. As the bankruptcy courts have gone electronic with their dockets of debtor cases, creditors have easier access to what is viewed by Congress in other contexts as private information. A creditor may now use the PACER electronic network to access information of court cases.

A number of federal courts have put entire civil case files online. Courts scan filed documents and make them available over the Internet. Privacy groups are concerned that electronic dockets create the opportunity for identity theft to commit credit card or bank fraud. Courts do not have a uniform policy as to public access to electronic court records. Courts are now considering restricting certain information on electronic court dockets. The FTC requests that courts withhold personal information from electronic court dockets.

The Bankruptcy Reform Act of 2001, which still awaits President Bush's signature, requires even more details concerning an individual's income and expenses under the "means test", which conflicts with GLB's privacy protections and what would be publicly available. The U.S. Congress, the Office of the United States Trustee and private bankruptcy trustees are wrestling with how to safeguard tax returns, wage statements and other sensitive data that are supplied in bankruptcy cases.

**C. Bankruptcy Reform Act of 2001**

In response to the Toysmart.com privacy pledge problem, Congress includes a provision in the Bankruptcy Reform Act of 2001 that prohibits companies in bankruptcy from selling their customer lists to raise money to pay creditors. Rather, a consumer privacy ombudsman is appointed in a bankruptcy case where a debtor attempts to sell its customer list. The ombudsman determines whether the customer list may be sold.

***III. Fair Credit Reporting Act***

In reaction to concerns over the privacy rights of an individual's consumer credit report, the FTC recently issued an opinion as to the application of the Fair Credit Reporting Act (FCRA) to commercial credit. The FTC states that a vendor must obtain a consumer's consent prior to pulling a consumer credit report, even for a legitimate business purpose. The FTC opinion also does not recognize a right to pull a consumer credit report for a personal guarantee without first obtaining consent.

The FCRA regulates the use of individual credit reports and credit information. Generally the collection of business, trade, and commercial credit reports are not covered by FCRA. The FCRA insures that credit reporting agencies, and the users of such reports, will respect a consumer's right to privacy by pulling consumer credit reports only after express written authorization of the consumer.

The FCRA requires that a credit grantor

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provide notice to the consumer if the credit grantor is denying credit, or otherwise taking adverse action with respect to the credit application, based upon the information obtained in the credit report. Thus, a credit grantor will provide notice to the company of the denial of credit; the credit grantor must also provide notice to the president, shareholder or guarantor with respect to whom the credit report was obtained.

The private enforcement provisions of the FCRA permit a consumer to bring civil suit for willful noncompliance with the FCRA, with no ceiling on punitive damages. The consumer may sue for negligent noncompliance, for actual damages sustained. The consumer may also seek to recover the consumer's attorneys' fees. In addition, criminal penalties may also be assessed including fines and imprisonment against any person who knowingly and willfully obtains a consumer report under false pretenses.

In light of the FTC's concerns over an individual's privacy rights, a credit professional should obtain express written permission to run a consumer credit report. The following type of authorization language should be considered in the credit application and personal guarantee form.

**A. FCRA Authorization Contained In Credit Application**

A credit professional extending trade credit may consider including the following language in the credit application to authorize obtaining consumer credit reports on the corporation's individual insiders, or LLC's individual members. This language should be included as a separate statement with signature block, or addendum to accompany the credit application, as the party that the credit professional seeks authorization is not the same party that signs the credit application. It should be noted that 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. Rather, the credit professional should obtain an authorization form from each party that a credit application is to be pulled.

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

**B. FCRA Authorization Contained In Personal Guarantee**

A credit professional requiring a personal guarantee for extensions of trade credit may consider including the following language in a personal guarantee form to authorize obtaining a consumer credit report from the guarantor.

> The undersigned consents to [insert: Name of Your Business] obtaining a consumer credit report on _________ [insert??name of the guarantor] for the purpose of evaluating the creditworthiness of _________ [insert??name of the guarantor], in connection with an application for business credit.

***IV. Privacy Commission***

In reaction to privacy concerns raised by privacy groups and the states, the U.S. Congress has appointed a commission to make recommendations to Congress on privacy legislation. The commission comprises a 17 member bipartisan Privacy Protection Commission. Congress has given the commission 18 months to study privacy issues and report to Congress. The commission will consider the need for privacy protection and the purpose for sharing information, as well as existing legislation and regulation.

***V. Right to Financial Privacy Act***

This federal law prohibits a financial institution from providing the U.S. government access to financial records of its customer, absent consent.

***VI. Pending Federal and State Privacy Legislation***

The U.S. Congress is considering the following privacy legislation: Consumer Internet Privacy Enhancement Act; Consumer Privacy Protection Act; Consumer Online Privacy and Disclosure Act; and Spyware Control and Privacy Protection Act. In addition, the U.S. Congress is considering a bill to restrict the sale of Social Security numbers. State legislatures are considering over 100 privacy bills.

**Privacy Legislation is Only Beginning**

A customer's privacy rights are at the forefront of legislation and regulation, and appear a hot topic into the future. Courts will be asked to interpret the legislation. As technology continues to shape the electronic credit department and the ease in which customer information may be collected and shared, a credit professional should be mindful of a customer's privacy rights and enactment of new legislation in this area.

### *PUBLIC ACCESS TO COURT ELECTRONIC RECORDS PROVIDES FOR IMMEDIATE INFORMATION OF STATUS OF PROBLEM ACCOUNTS (Continued)*

*(continued from page 1)*

within each court, each jurisdiction will have a different URL or modem number. Consequently, the format of each court's information is slightly different. Notwithstanding this, access is typically straightforward with little instruction required.

Systems requirements are minimal. A personal computer or terminal and, for dial-up PACER, just a 9600 or higher baud modem and terminal emulation software that supports VT100 emulation. For Internet PACER, Internet access and a Javascript enabled web browser are all that is required. Parties are charged a fee of $.60 a minute for dial-up service and an access fee of $.07 per page is assessed for access to PACER service on the Internet. Transactions are managed through matter numbers to ease accounting issues.

Electronic access is available by registering with the PACER Service Center. To register, fill out one of the registration forms available on the PACER website, http://pacer.psc.uscourts.gov/. Alternatively, you may contact the PACER Service Center for a registration form at (800) 676-6856. There is no cost for registering and once the registration form is received by the PACER Service Center, you will receive a login and password in the mail within a couple of weeks. Oddly, logins and passwords cannot be faxed, emailed, or given over the phone.

Next quarter, we will discuss the next stage in court technological advances, the age of electronic court filing.

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# RECENT ENGAGEMENTS AND ACTIVITIES

*Blakeley & Blakeley LLP Recent Engagements and Activities for Summer 2001*

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

o Spoke to the **CMA's Equipment Lessors Industry Group** regarding the **Revised Article 9 of the Uniform Commercial Code.**

❑ Spoke at the **Annual CMA Business Credit Services Conference** regarding the **Internet, E-Credit and Legal Issues Affecting the Credit Professional.**

❑ Spoke to **CMA's Book Manufacturers Industry Group** in **Oakland** regarding **Accepting Credit Card Payment for Commercial Credit Sales.**

❑ Spoke to **NACM/Southwest National Telecommunications Group** in **Las Vegas** regarding **The Risks and Opportunities of Selling to a Dot-Com.**

❑ Spoke to **CMA's National Mass Merchandisers Credit Group** regarding **Vendor Agreements.**

❑ Spoke to **CMA's Computer Industry Group** regarding **Serving on a Creditor's Committee.**

❑ Spoke to **NACM/Chicago-Midwest National Housewares Manufacturers Industry Group** in **Las Vegas** regarding **Antitrust and the Electronic Credit Department.**

❑ Spoke to **NACM/Chicago-Midwest National Manufacturers Group** in **Las Vegas** regarding the **Internet, E-Credit and Legal Issues Affecting the Credit Professional.**

❑ Spoke at **NACM's Credit Congress** in **Seattle** regarding the **Top Ten Bankruptcy Topics** and the **Internet, E-Credit and Legal Issues Affecting the Credit Professional.**

❑ Spoke to the **Staffing Services Group at NACM's Credit Congress** in **Seattle** regarding **Collecting on Your Judgment.**

❑ Spoke to **Reimer Reporting's National Store Retailers Group** in **Seattle** regarding **Beating the Bankruptcy Preference.**

❑ Spoke to **CMA's Institutional Food Group** regarding **Beating the Bankruptcy Preference**.

❑ Spoke to **Reimer Reporting's National Bicycle Credit Group** in **Seattle** regarding the **Top Ten Bankruptcy Topics.**

❑ Spoke to **Sony Pictures** regarding the **Equal Credit Opportunity Act, the Fair Credit Reporting Act, Selling to Limited Liability Companies** and **Revised Article 9 of the Uniform Commercial Code.**

❑ Spoke at the **America Credit Association's National Convention** in **Las Vegas** regarding the **Equal Credit Opportunity Act** and the **Fair Credit Reporting Act.**

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