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

USING REPAYMENT AGREEMENTS IN OUT OF COURT WORKOUTS

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Your long term customer (a retailer) has a sizeable balance past due on their account, and is heading into their slow season. Discussions with other vendors selling the customer on credit reveal similar payment delinquencies. Your experience is that too often when a customer is being chased for payment by vendors, especially the customer's lender, a Chapter 11 may be imminent.

With a Chapter 11 filing, the customer may obtain the protections of the automatic stay to enjoin creditors from further collection efforts. However, as a result of a number of creditor friendly provisions in the Bankruptcy Reform Act of 2005, debtors are reconsidering their financial restructuring alternatives to Chapter 11.

Because of the special treatment that certain creditor classes now receive under the Reform Act, as well as the pressure the debtor faces to exit Chapter 11 much faster, vendors may find more customers approaching them with repayment proposals on their delinquent accounts as part of a comprehensive out-of-court strategy of dealing with its creditors.

A debtor's hope for deferral of immediate payments owing to vendors may allow the debtor breathing room to stay out of Chapter 11, while it continues to address its financial difficulties. What provisions of the Bankruptcy Reform Act are forcing debtors to consider out-of-court restructuring alternatives? What kind of out-of-court workouts are there? What are common terms contained in a repayment agreement?

A. The Bankruptcy Reform Act and the New Playing Field for the Customer

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 ("Reform Act"). 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 Reform Act also 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 forcing them to consider alternative out-of-court financial restructurings to Chapter 11.

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PROCEEDS FROM AN ASSIGNMENT OF YOUR CUSTOMER'S LETTER OF CREDIT—ARE THEY PREFERENTIAL TRANSFERS?

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A letter of credit (L/C) may be broadly defined as an undertaking by an issuer, the bank, to pay a third party, the creditor who is the beneficiary for the account of the bank's customer, the debtor, when the creditor submits documents specified by the L/C. An L/C may serve as a guarantee, securing performance of an obligation with a bank's commitment to pay upon presentation of a draft, default notice or other documents specified by the L/C.

Recent bankruptcy decisions have addressed the issue of whether the proceeds from an L/C are preferential when the beneficiary to the L/C is the creditor. These decisions have held that such proceeds are not preferential when the L/C is issued prior to the start of the preference period. But what about a situation where the debtor is the beneficiary and the debtor assigns its interests in the L/C to its creditors? These are the facts in the recent case of *In re Cooper Mfg. Corp.*

In *Cooper*, the Texas bankruptcy court faced the issue of whether the proceeds from an assigned L/C were preferential transfers when the assignment from the debtor to its creditors occurred prior to the start of the preference period, but the proceeds were received by the creditors within the preference period. The Chapter 7 trus-

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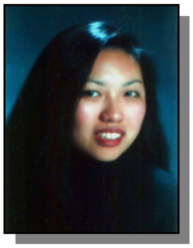

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An alternative to Chapter 7 liquidation is an assignment for the benefit of creditors ("ABC"), a formal out-of-court liquidation of debtor's assets where a debtor gives title to all of its assets to a fiduciary who then liquidates the assets and pays the creditors with the proceeds. The fiduciary has the power to recapture "preferential transfers", payments to creditors within the 90 days preceding the assignment. ABC's have been adopted by Arizona, Arkansas, California, Colorado, Delaware, District of Columbia, Florida, Georgia, Indiana, Iowa, Kentucky, Rhode Island, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, New Jersey, New Mexico, New York, North Carolina, South Carolina, South Dakota, North Dakota, Ohio, Oklahoma, Pennsylvania, Tennessee, Utah, Vermont, Virginia, Washington, West Virginia and Wisconsin.

The Ninth Circuit Court of Appeals, through a majority opinion in *Sherwood Partners, Inc. v. Lycos, Inc., 394 F.3d 1198*, held that the federal Bankruptcy Code preempts California Code of Civil Procedure section 1800 which grants the fiduciary of an ABC the power to void preferential transfers. However, the court in *Haberbush v. Charles and Dorothy Cummins Family Limited Partnership, et al., 139 Cal.App.4th 1630 (Cal.App. 2 Dist. 2006)*, disagreed with the *Sherwood Partners* majority opinion.

Preemption and the *Sherwood Partners* Decision

Congress may preempt state law expressly or impliedly. For there to be preemption impliedly, it must be "clear from the statute and surrounding circumstances that Congress intended to occupy the field, leaving no room for state regulation." *Sherwood Partners*, 394 F.3d 1198, 1200.

In deciding a preemption issue, the court looks to whether the state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Hines v. Davidowitz* (1941) 312 U.S. 52, 67.

The *Sherwood Partners* majority found that the fiduciary's power to avoid preferential powers was inconsistent with the federal bankruptcy laws and tread too closely to a federal trustee's avoidance power. "One of the major powers the [Bankruptcy] Code gives the trustee is the power to avoid preferential transfers. . . [and] may be exercised only under the supervision of the federal courts. Federal law protects creditors-particularly out-of-state creditors like Lycos-from the trustee's possible conflicts of interest and other possible sources of self-dealing." 394 F.3d at 1204. The court was also concerned that the fiduciary could recover preferences under state law and still face a bankruptcy proceeding where a bankruptcy trustee could not also pursue preference claims against the same creditors.

The *Haberbush* Facts

Carolyn's Country Pies, Inc. executed a voluntary general ABC to David R. Haberbush ("Haberbush"). As the assignee, Haberbush filed three lawsuits to avoid and recover preferential transfers to insiders. Haberbush obtained judgments in all three lawsuits, and each defendant appealed.

The *Haberbush* Decision

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FROM THE PUBLISHER:

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BAPCPA PREFERENCE AMENDMENT ON ORDINARY COURSE OF BUSINESS DEFENSE MIGHT NOT BE AS CREDITOR-FRIENDLY AS IT PROMISED

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The BAPCPA amendments to bankruptcy preference provisions provide more protection to the creditors by splitting the ordinary course of business defense into an either/or proposition. By evaluating either the ordinary course of business or the ordinariness of the terms of the transaction, instead of meeting both prongs, the amendments protect payments to creditors that are made in accordance with ordinary terms of the transaction, even if they cannot be shown to be ordinary with respect to the course of business.

However, in a recent decision, a North Carolina court held that although the new provision reduces the creditor's burden of showing the ordinariness of the transaction, it was not enough to provide a defense to the creditor in *In re National Gas Distributors, LLC* (Bankr. E.D.N.C. 2006).

In *National Gas Distributors*, the trustee sought to avoid and pursuant to 11 U.S.C. sections 547 and 550, preferential transfers aggregating $3,263,516.15 made by the National Gas Distributors ("NGD") to Branch Banking and Trust Company ("BB&T"). BB&T's defense under section 547(c)(2)(B) was that the transfers were not avoidable because they were made according to ordinary terms of business.

NGD was a purchaser and distributor of natural gas. None of NGD's obligations to BB&T were secured by NGD's assets, but all of the obligations were subject to the guaranties of Mr. Lawing and his wife, and all of the obligations were secured by assets owned by Mrs. Lawing. Two credit facilities were paid with transfers that were the subject of the preference proceeding: the revolving line of credit, and the working capital loan.

The line of credit obligation was to mature on November 5, 2003 and was extended

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BAD CHECKS AND BANKRUPTCY: CAN YOUR DEBTOR DISCHARGE YOUR "NSF" DEBT?

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You conclude that a sole proprietor applicant is too much credit risk and you insist on a cash payment for the initial order. You authorize shipment of the goods, with your delivery driver to pick up a check from your customer. The goods are delivered, but the business check is returned "NSF".

The customer files personal bankruptcy and schedules your claim, which is based on the NSF check, as unsecured and to be discharged through the bankruptcy. By virtue of the customer issuing the bad check, do you have a legal basis to have your claim deemed nondischargable, and the debt survive the customer's bankruptcy, thereby allowing you to pursue payment in the future?

A. Overview of Bad Check Laws

Bad check law is governed by state law and all states have such laws. Bad check law combats fraud: the buyer of goods and services deceives the vendor into believing that payment is made, and the vendor releases the goods or provides the services in reliance on this.

Generally, a vendor is required to establish the buyer's intent to defraud and knowledge of insufficient funds for a valid claim under the bad check laws. Most states provide that it is prima facie evidence of the insufficient funds if: (a) the check was not honored, and (b) the buyer did not pay the check after written notice of dishonor of the check. Under the bad check laws, a vendor may have claims against the buyer on a civil basis (collection of the debt) and a criminal basis.

B. Check 21 and Bad Check Laws

On October 28, 2004, the Check Clearing for the 21st Century, federal legislation affecting all states, went into effect. Check 21 changes the method that checks are processed in the United States, went into effect. Check 21 changes the method that checks are processed in the United States, as well as changes the technology of check payment and acceptance. With Check 21, financial institutions may process checks electronically, instead of transporting the paper checks. With checks being processed electronically, checks are expected to clear promptly, not in days. Notification of NSF checks may change significantly post-Check 21. Post-check 21, the vendor may learn promptly of an NSF check because the float time is less and most banks will offer notice of NSF checks via email or on-line. Some banks may continue to mail notice of the NSF checks. Each bank may set up its standard for immediately notifying vendors of NSFs.

At this point, it appears that banks may set their own standards for the redeposit procedure, after the initial attempt fails. The bank may redeposit the check without returning the check to you, based on your instructions to them. Or, the bank may issue a substitute check stamped "Returned due to NSF" and return the check to you. The substitute check is the legal equivalent of the original, so you may use this for reporting to the police authorities.

C. Bad Checks and Bankruptcy

1. Elements of A Nondischargeable Action

Should a debtor that files bankruptcy defraud a vendor, for example, by issuing a check when there are insufficient funds, the vendor may be able to have its claim "ride through" bankruptcy. The procedure for the vendor's NSF debt to survive a debtor's bankruptcy discharge, the vendor must file a lawsuit in the bankruptcy court to have its debt ordered non-dischargable, or object to the debtor's discharge, wherein all of the debtor's debts are ordered non-dischargeable.

The most common causes of action to exclude a vendor's debt from discharge are: (1) fraudulently incurred obligations; (2) fiduciary fraud and embezzlement; and (3) willful and malicious acts.

The nondischargable provisions contained in the Bankruptcy Code provide that the debtor must be an individual. Thus, if the vendor sold to a sole proprietorship, or holds a personal guarantee on a sale to a corporation, LLC or partnership, the vendor has a claim against an individual. There are no dischargable claims against a corporation, as the corporation is not entitled to a

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RELEASING YOUR LIEN AS A PREFERENCE DEFENSE: STEPS TO PRESERVE THE DEFENSE

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A fundamental responsibility of a credit executive is assessing a debtor's credit risk. For credit executives employed by subcontractors and material suppliers, states as well as Congress have created special protections to these vendors to reduce or eliminate credit risk through state and federal lien laws. However, what is the effect of the state lien laws where the general contractor files bankruptcy? Are payments made to the subcontractor and material supplier during the preference period recoverable by a bankruptcy trustee, or do the states' and federal lien laws protect the vendors from the preference risk? A recent bankruptcy case which considered the interplay of lien law and federal Bankruptcy Code's preference provision is considered.

The Bankruptcy Preference Law

The Bankruptcy Code vests the trustee with far reaching powers to avoid transfers and transactions prior to a bankruptcy filing. The power to avoid preferential transfers is one of the trustee's most potent weapons. The Bankruptcy Code defines a preferential transfer expansively to include nearly every transfer by an insolvent debtor during the preference period. Vendors are discouraged from racing to the courthouse to dismember a debtor, thereby hastening its slide into bankruptcy. A debtor is deterred from preferring a vendor by the requirement that any vendor that receives a greater payment than similarly situated vendors disgorge the preference so that like vendors receive an equal distribution of the debtor's assets.

Not all transfers made within the preference period may be recaptured. For example, transfers intended by the debtor and creditor to be a contemporaneous exchange and was in fact a substantially contemporaneous exchange may serve as an absolute preference defense. But how does a subcontractor's release of lien affect the contemporaneous exchange preference defense?

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BAD CHECKS AND BANKRUPTCY: CAN YOUR DEBTOR DISCHARGE YOUR "NSF" DEBT?

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discharge in bankruptcy. If the vendor sold to a corporation, and the insider of the corporation filed bankruptcy, the vendor may still have a nondischargable claim against the individual, but must establish an alter ego claim against the insider.

Where property is obtained by the debtor's false pretense, false representation or actual fraud such claim may be exected from discharge. Under the fraud nondischargability provision, the vendor may establish either oral or written fraud by the debtor. With the oral fraud, the vendor must establish fraud and its reasonable reliance on the debtor's representation. If the fraud is in writing, the vendor must establish that the false representation (bad check) is materially misleading and the vendor reasonably relied on the false representation.

The vendor may also have its claim ride through bankruptcy where it can be established that the debtor defrauded the vendor while in a fiduciary capacity, such as officer of the corporate debtor. The vendor may also have its claim ride through bankruptcy where the debtor committed a willful injury.

If the vendor seeks to deny a debtor's discharge, an objection may be based on the following: (1) the debtor transferred, concealed or destroyed property within one year before the bankruptcy filing or any time after the filing; (2) the debtor concealed, destroyed or failed to keep books and records; (3) the debtor made a false oath or withheld information from an officer of the estate; (4) the debtor is unable to explain loss of his property; (5) the debtor has received a discharge in a prior bankruptcy within six years; and (6) the debtor has had a discharge waived or denied in a prior bankruptcy case.

However, with an NSF debt it is unlikely that grounds may exist to deny a debtor's discharge based on an NSF check. Many of the grounds for objecting to a discharge may also constitute federal crimes. Be mindful that the vendor must act quickly with commencing these claims, which may require filing 60 days after the First Meeting of Creditors.

How does a bankruptcy court treat an NSF debt in bankruptcy? May a vendor use the nondischargability provisions to have their claim survive bankruptcy? The bankruptcy court in *In re Beza* considered the topic.

D. Bad Checks and Bankruptcy in Action

In *In re Beza*, the debtor, a sole proprietor, presented two checks to a creditor, and in exchange the creditor provided cash. The debtor closed the checking account and withdrew the remaining funds. When the creditor presented the checks to the debtor's bank for payment the check were returned unpaid and marked "account closed." The debtor filed personal bankruptcy, seeking to discharge the bad check. The creditor filed a nondischargable action with the bankruptcy court, seeking to have the bad check debt survive the bankruptcy discharge.

The bankruptcy court looked to the nondischargeability provisions of the Bankruptcy Code in considering whether the NSF debt survived bankruptcy. A creditor proceeding under the nondischargeability provision of Section 523(a)(2) of the Bankruptcy Code must prove the following elements:

(1) the debtor made false representations; (2) the debtor knew the representations to be false; (3) the debtor made the representations with the intention of deceiving the creditor; (4) the creditor relied on the representations; and (5) the creditor sustained the alleged injury as the proximate result of the representations.

As to the first element, courts have found that delivery of an ultimately dishonored check, without more, may not constitute an actionable representation under Section 523(a)(2). If the surrounding circumstances indicate that the debtor intended to deceive the vendor when using an insufficient funds check, and when the debtor knew that sufficient funds did not exist, a debtor is not entitled to discharge the debt. The court concluded that the debtor impliedly represented to the vendor that sufficient funds existed to cover the checks, which representation was obviously false.

The second element required that the debtor knew the representation was false when made. The court noted that when the debtor issued checks totaling nearly $20,000 to the creditor, and the account upon which the checks were drawn had a balance of a few hundred dollars. The substantial discrepancy between the amount of the checks presented to the creditor and the amount of funds in the account, the court concluded that the debtor knew the implied representation that he possessed sufficient funds to cover the checks was false.

Direct evidence of the third element of intent usually does not exist. The court concluded that the substantial discrepancy between the amounts of the checks presented to the creditor by the debtor, and the amount in the account shows that the debtor possessed the intent to deceive.

The fourth element requires a showing that the creditor relied on the representations. The court concluded that the creditor relied on the debtor's representation that there were sufficient funds in the account to cover the checks, and that such reliance was not unreasonable given the debtor's status as a neighboring business owner.

Finally, the fifth element required for nondiachargeability is that the creditor sustained the alleged injury as a result of the representations having been made. The debtor's misrepresentations caused the creditor to suffer the loss of the $19,000 in exchange for the checks. The court found the debt was non-dischargeable.

E. Issues With Bad Checks And A Customer's Bankruptcy

In crafting the nondischargeability exceptions to the Bankruptcy Code, Congress intended that a dishonest debtor might not evade its debts, even where a debtor has issued an NSF check. With these provisions, a vendor may be able to have its NSF debt ride through bankruptcy. The credit professional must be mindful of the time limits to timely file a complaint to have the NSF debt found nondischargeable.

RELEASING YOUR LIEN AS A PREFERENCE DEFENSE: STEPS TO PRESERVE THE DEFENSE

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Mechanic Lien Law

State mechanic's lien laws ensure payment to vendors extending credit for supplying labor and materials that improve property, by allowing the vendors to look to the owner of the property for payment. Many states provide for a payment bond in lieu of a mechanics lien.

Generally, the subcontractor must give preliminary notices to the property owner and others, depending on the state statute. The time limit is generally connected with the last date on which the goods or services have been supplied to a particular job. The subcontractor must also record a claim of a lien in the county filing office. The mechanic's lien attaches to property immediately when the claimant supplied the labor or materials. The claimant must initiate a legal proceeding by filing a complaint for a foreclosure and records a notice of lis pendens. The vendor must be mindful that each state's lien law may vary in terms of notice requirements and protection afforded the vendor.

The Miller Act

For the subcontractor, the Miller Act, a federal law, provides for payment protection for services provided and goods furnished for improvement of a public construction project. The Miller Act requires a payment bond be posted, which provides for payment of first and second tier subcontractors covered by the prime contract. The subcontractor must show that it provided services or material for the project.

A prime contactor is barred from requiring a subcontractor to waive its bond rights prior to starting work. A subcontractor that is first tier does not have to file a preliminary notice; however, junior subcontractors must give the prime contractor notice within 90 days after they last provided product or service. The subcontractor must sue within one year after the subcontractor last provided the product or service, otherwise the claim is lost.

Interplay of Federal Bankruptcy Preference Law and State and Federal Lien Law

Whether a subcontractor who is protected under a state or federal lien law must return preference payments when the general contractor files bankruptcy raises the doctrine of preemption. A state's lien laws are created by the state legislature, while the bankruptcy laws are created by Congress and are a federal statutory scheme.

Preemption may exist if Congress passes a federal law that is intended to block enforcement of a federal or state law, here the lien laws. While Congress crafted the Bankruptcy Code to cover most aspects of debtors and their creditors, there are a number of state laws that also govern these rights.

Where a court is requested to interpret whether a law, here the Miller Act, is preempted by a federal law, here the Bankruptcy Code, the inquiry is whether the law conflicts with the federal law. In a recent decision, the bankruptcy court in *In re JWJ Contracting, Inc.,* considered whether the bankruptcy law were preempted a federal lien laws, thereby opening the door for vendor to face a preference claim.

Releasing Lien As A Preference Defense

In *In re JWJ Contracting,* the debtor, a general contractor, entered into a public works contract to perform work at an airport. The debtor posted a bond guaranteeing completion of the project and payment in full to material suppliers and subcontractors.

The debtor ran into financial difficulty and fell behind on its payments to the material suppliers and subcontractors. The subcontractors threatened to demand payment from the bond insurer. As a result the debtor issued two checks to two particular subcontractors, and in return the subcontractors executed unconditional lien releases that waived their rights to payment under the bond.

Within 90 days of the subcontractors receiving the checks, the debtor filed bankruptcy. The trustee filed preference actions against the two subcontractors. The subcontractors sought dismissal of the preference actions, contending that they had an absolute preference defense as they released the liens in exchange for payment.

The subcontractors defense was grounded on the principal that the transfer of new value to the debtor was offset by the payments, and the debtor's estate was not depleted to the detriment of other creditors.

With regards to the subcontractors' lien rights as to public projects, the court noted that the Miller Act was passed to protect the labor and material suppliers in government construction projects. In effect, the Miller Act places subcontractors to government contractors on substantially equal footing with subcontractors to private contractors.

With respect to one of the subcontractors, the court held that the debtor did not give the subcontractor the check in exchange for release of the lien. Rather, the debtor simply complied with the subcontractor's request, which was to provide the subcontractor with the second check to replace the first NSF check written by the debtor. The second check was therefore not exchanged contemporaneously for new value when the subcontractor signed the unconditional release.

The court erred in granting judgment for the subcontractor as the subcontractor released its claim against the bondholder prior to receiving the payment, and the payment was not exchanged for new value.

Regarding the other subcontractor's claim, the bankruptcy court stated that new value arises only to the extent that the released claim was secured. The court needed to determine the extent to which the bondholder's contingent claim against the debtor was secured. To do that, the court needed to determine at the time of the subcontractor's payment, the amount of mature claims of the subcontractors on the project and compare that number to the amount of contract proceeds remaining to be paid on the project. The court would then be able to assess whether the bond holder was fully or partially secured on its contingent claim when the payment was made to the subcontractor.

The court found that the lower court erred in ruling in favor of the subcontractor as it made no determination regarding the extent to which the bondholder was secured when the subcontractor payment was made and the subcontractor released its claim against the bondholder.

Preserving the Preference Defense

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tee brought adversary proceedings to recover, as preferential, transfers made to four creditors under an alleged assigned L/C. The trustee moved for partial summary judgment, and two creditors cross-moved for partial summary judgment.

In ruling on the summary judgment motions, the court analyzed the issue of the assignment and prior decisions relating to assignments. To support his argument, the trustee primarily relied on the case of *Diversified World Investments, Limited v. Omni International, Limited*. In *Diversified,* the court held that the transfer occurred when the payment was made pursuant to an assignment of rental payments. The debtor in *Diversified* assigned its right to payment under an aircraft lease agreement to a creditor. The assignment took place outside the preference period, but the payment was received by the creditor within 90 days of the bankruptcy filing. The *Diversified* court believed that Section 547(e)(3) was intended to bring payments made pursuant to an assignment within the term "transfer" because, under Section 101 (40) of the Bankruptcy Code, the term transfer was intended to be as broad as possible.

The court in *Cooper* determined that the *Diversified* court confused the contractual right to receive payment with the right to demand actual payment, citing that a beneficiary of a letter of credit has a contractual right to the proceeds once the letter of credit is issued. Accordingly, the debtor had a right to the LOC proceeds before it made the assignments, and the transfers occurred when debtor assigned LOC proceeds to creditors, not on date on which creditors actually received proceeds. The court concluded that for the purpose of calculating the preference period under Section 547(b), a transfer occurs on the date the contractual right to the proceeds is assigned, not on the date the payment is actually made.

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to December 23, 2005. On December 15, 2005, NGD transferred to BB&T to pay the balance outstanding under the line of credit note.

The working capital loan was to mature on March 27, 2005 but the maturity was extended to December 23, 2005. On December 19, 2005, NGD transferred to BB&T to pay the balance outstanding under the working capital note.

It was undisputed that the trustee has met his burden of establishing the elements of section 547(b) and may avoid the two payments unless BB&T could establish its ordinary course of business defense. The ordinary course of business was amended by the Bankruptcy Reform Act, which allows transfers made in the ordinary course of business, or made according to ordinary business terms. The section includes both an "ordinary course of business" defense and a separate, independent "ordinary business terms" defense.

BB&T stated that BB&T as a matter of routine practice extended the maturity dates of the line of credit note and the working capital note. It was a customary practice within BB&T and the banking industry to execute modification agreements extending maturity dates. BB&T also stated that neither note was ever in default, and BB&T made no attempt to collect on the notes. The notes were paid in full as "part of Mr. and Mrs. Lawing's end-of-the-year estate planning."

Although the Bankruptcy Reform Act recommendations intended that the objective industry standard of "ordinary business terms" should only be utilized where no course of dealing between the parties has been established, the Court in this case adopts the view that the objective "ordinary business terms" defense to be used where a course of dealing existed and even where the transfers at issue clearly deviated from that course of conduct.

BB&T introduced the standard in *Advo-System* held by the Court of Appeals for the Fourth Circuit that the industry standard to be applied when examining "ordinary business terms" is that of the creditor's industry. BB&T argued that the applicable industry standard is that of the banking industry. It was standard banking practice for a bank to receive payment on a note shortly before the note matures.

The Court in this case looked at *In re Accessair* held by the Eighth Circuit Court that it is the debtor's industry that is the focus of the "ordinary business terms" analysis. The Bankruptcy Reform Act now requires an examination of the industry standards of both the debtor and its creditors.

The Court concluded that BB&T's general statement that a payment met banking standards was not sufficient. The Court stated that it was not standard in the banking industry for a borrower with a multimillion dollar enterprise to pay all of its corporate loans based upon the owner's end-of-the-year personal financing planning. The conduct of the debtor in paying its loans was not in accordance with "ordinary business terms." NGD was going out of business and was paying off those debts which Mr. and Mrs. Lawing guaranteed. These payments were not made "according to ordinary business terms" and were not the type of transfers that the "ordinary business terms" defense was designed to protect.

The decision reached by *National Gas Distributors* reflects the Court's unwillingness to use the amendment to protect payment that was extraordinary in relation to the rest of the debtor's financial affairs. The Court rejected the "ordinary business terms" defense not because the terms were extraordinary, but because it was extraordinary when viewed in light of what else was happening in the debtor's business, such as the owner's end-of-the-year personal financing planning.

A STRIKE AT THE FINDING OF PREEMPTION IN SHERWOOD PARTNERS, INC. V. LYCOS, INC.

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After the appeals were filed, the Ninth Circuit issued its opinion in *Sherwood Partners*. The Court in *Haberbush* dispenses with the majority opinion in *Sherwood Partners* on the following points:

1) Congressional Intent

ABC's were expressly upheld in *Pobreslo v. Joseph M. Boyd Co.*, (1933) 287 U.S. 518, 526, "[a]nd, quite in harmony with the purposes of the federal Act, the provisions of [Wisconsin law] that are regulatory of such voluntary assignments serve to protect creditors against each other and go to assure equality of distribution. . . ."

2) Implication does not equate to an obstacle

The *Sherwood Partners* court suggests that any state statute that implicates the federal bankruptcy law's goal of equitable distribution is preempted by federal law. However, the statutes upheld in *Pobreslo* and *Stellwagen v. Clum*, (1918) 245 U.S. 605, implicated the same goal of equitable distribution but were not found to be incompatible with federal bankruptcy law. As such, implication does not equate to an obstacle to achieving federal goals.

3) No interference with goal of equitable distribution

The majority suggested that voluntary ABC's would "affect the incentives of various parties as to whether they wish to avail themselves of federal bankruptcy law" 394 F.3d at 1205, however, Judge Nelson in her dissent correctly observed that it is "illogical that state laws that provide a forum for the equitable distribution of that property should be preempted by federal bankruptcy law." 394 F.3d at 1207 (dis. opn. of Nelson, J.).

4) Achieves the same goal of equitable distribution

The majority points out that if a preferential transfer is recovered by the transferee, the same amount could not be recovered if a federal bankruptcy proceeding was filed. However,

"California's preference recovery provision is, by design, virtually identical to the bankruptcy code's preferential transfer statute. [Citations.] If the same transfer can be avoided in both the state and federal systems, how does the state system interfere with bankruptcy's goal of equitable distribution? Both the state and federal statutes serve to ensure equality of distribution and to deter the race to recover assets before insolvency. [Citations.] That California's voluntary assignment system has such a provision makes it more capable of effectuating the equality of distribution that is the aim of the bankruptcy law; it does not necessarily interfere with bankruptcy's goal of achieving equal distribution." 394 F.3d at 1207-08 (dis. opn. of Nelson, J.).

5) Co-existence

There is no evidence that Congress intended to preempt ABC's generally or to preempt preferential transfer laws. Voluntary assignments and the bankruptcy system have co-existed since the inception of bankruptcy law, and state laws regulating the rights and obligations of debtors or their assignees and creditors are often expressly incorporated in bankruptcy law.

The Court could not distill any persuasive reason for California Code of Civil Procedure section 1800 to be preempted by federal law.

Conclusion

Haberbush attempts to strike a blow to the finding of preemption by the Ninth Circuit Court of Appeals in *Sherwood Partners*, but we'll have to wait and see how this issue is treated by other courts for a more definitive conclusion of whether a fiduciary of an ABC has the power to avoid preferential transfers.

USING REPAYMENT AGREEMENTS IN OUT OF COURT WORKOUTS

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

Some of the provisions under the Reform Act that may force debtors to consider alternative out-of-court financial restructurings to Chapter 11, include:

1. Employee Wages

Prior to the Reform Act, employee wages were given priority up to $4,000 for each individual earned within 90 days before bankruptcy. Under the Reform Act, employee wages and salaries are increased to $10,000 for each individual up to 180 days before the bankruptcy.

This means more of the debtor's cash is dedicated to employees' claims which results in less cash available for operations.

2. Landlord Claims

Prior to the 2005 Reform Act, a debtor had 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.

Under the Reform Act, a debtor must assume or reject its real 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.

This means 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.

3. Utilities

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USING REPAYMENT AGREEMENTS IN OUT OF COURT WORKOUTS

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Prior to the Reform Act, the debtor must have provided adequate assurance to a utility within 20 days of filing. Under the Reform Act, a debtor offering a utility an 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 requires debtors to provide utilities with cash deposits or credit enhancements during the early stage of the Chapter 11, which means that there are fewer assets for operations.

4. Reclamation

Prior to the Reform Act, reclamation claims had to be brought within 10 days after the debtor received the goods or, if such 10-day period expired after the bankruptcy, within 20 days. The reclaiming creditor also had to prove up the goods were on hand at the time of the reclamation demand and the debtor was insolvent.

The Reform Act expands the time for reclaiming creditors to make their reclamation demand to 45 days after the debtor receives the goods or 20 days after the bankruptcy. The value of the goods shipped to the debtor within 20 days prior to the bankruptcy is given an administrative claim. This means that more of the debtor's assets will be dedicated to reclamation claims.

C. Both Large and Small Corporate Customers, as Well as Personal Guarantors, Face More Constraints Under the Reform Act

In addition to the greater administrative expenses for special creditor interests that a debtor must endure, the Reform Act has also created greater leverage for creditors as well as pressure for the debtor to exit earlier from Chapter 11.

1. Large Corporate Customers Facing Insolvency

The owners and professional managers of corporations, LLC's and partnerships, as well as personal guarantors, may seek alternative out-of-court financial restructurings to Chapter 11 given a number of creditor-friendly provisions contained in the Reform Act, including the following:

a. Exclusive Right to File Plan of Reorganization Shortened

Prior to the Reform Act, debtors had the exclusive right to file a plan of reorganization within the first 120 days of the bankruptcy filing, and an additional 60 days to solicit acceptance of the plan. A bankruptcy court could extend the exclusivity period indefinitely upon the debtor establishing "cause".

The Reform Act limits the debtor's exclusive right to propose a plan to 18 months. After that, there can be competing plans from creditors and creditor's committees.

This means that debtors are under pressure to exit bankruptcy earlier, as well as losing leverage in negotiations with creditors.

b. Employee Retention Bonuses and Severance Programs

Prior to the Reform Act, corporate debtors in the opening days of a chapter 11 would often request the bankruptcy court approve a bonus scheme for management. Vendors would often view such requests by management as overreaching and an attempt by management to enrich themselves at their expense.

Under the Reform Act, in order for the debtor's management to obtain approval of a key employee retention plan, the debtor must establish that a retention or stay bonus is essential to induce management to continue employment. For the insider to be entitled to such a bonus, he or she must have a job offer from another business. In addition, the insider's services must be essential to the debtor.

The retention bonus and severance package cannot exceed ten times the amount paid to non-management persons within the year in which the transfer is made or, in the absence of such non-management bonuses, it cannot exceed 25 percent of the amount of bonuses transferred to the insider during the year prior to the retention bonus.

A debtor's management will view these restrictions negatively as they believe it leads to the departure of key personnel viewed as essential to the reorganization.

c. Appointment of trustee

The Bankruptcy Code provides that existing management continues in place in Chapter 11. The Reform Act provides that the U.S. Trustee must file a motion to appoint a trustee if there are grounds to suspect that the debtor's management committed fraud or dishonesty.

This provision may prompt more motions to displace management and perhaps action by the board of directors to remove officers that may be alleged to be involved in questionable activity.

2. Small Business Customers Facing Insolvency

Prior to the Reform Act, a small business Chapter 11 debtor was one with non-contingent liquidated, secured and unsecured debts less than $2 million, as of the date of the bankruptcy filing. The debtor could elect not to be a small business debtor. Under the Reform Act, there is no election. If the debtor's assets are less than two million then it must be a small business debtor. The small business debtor faces the following restrictions:

a. More Financial Reporting

The small business debtor has extensive financial reporting requirements, such as periodic filings reporting on profitability and expenses, and the U.S. Trustee is to scrutinize the small business reporting.

b. Pressure on the Debtor to Exit Bankruptcy Early

Only the debtor can file a plan within the first 180 days, and a plan must be filed within 300 days of filing bankruptcy. The plan must be confirmed within 45 days after it is filed.

c. No Chapter 22

A small business debtor may not file a second Chapter 11 within two years of a Chapter 11 being confirmed or dismissed. An exception is if the debtor can establish that a plan can be confirmed within a reasonable time.

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USING REPAYMENT AGREEMENTS IN OUT OF COURT WORKOUTS

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3. Personal Guarantors Facing Insolvency

Prior to the Reform Act, an honest debtor was entitled to discharge its debts under Chapter 7, notwithstanding the debtor's post-bankruptcy income. The Reform Act imposes restrictions on an individual's use of Chapter 7 to escape its debts.

a. Means Test

The Reform Act makes it more difficult for individuals to file Chapter 7 liquidation by imposing a means test, which determines whether the individual debtor has the ability to repay a significant portion of their debts through future income (post-bankruptcy filing). If, after computing a debtor's income and expenses, it is determined that a debtor is able to repay their debts, then the Chapter 7 case may be dismissed or converted to Chapter 13.

For a vendor holding a personal guarantee, the means test may force the guarantor to repay a portion of the guaranteed debt through a Chapter 13 plan, if the guarantor's income is too great, or simply stay out of bankruptcy as they may not be eligible to discharge the debts.

D. Forms of Out-of-Court Workouts and Liquidations

A debtor has a number of alternative forms for an out-of-court workout or liquidation, which are considered below. While a debtor may consider out-of-court workouts, the larger and more complex the debtor's operations are, including a complex debt structure of bondholders, noteholders and mezzanine debt holders, the more difficult it is for the debtor and its creditor groups to reach consensus. Therefore, Chapter 11 may be required with the large, complex debtor. However, a prepackaged plan under Chapter 11, discussed below, may be an alternative.

1. Workouts

In this setting, the debtor attempts to continue to operate as it works through its financial difficulties and creditor delinquencies. The vendor may deal with the delinquent account on an individual basis or a collective basis.

Both the large and small corporate debtors may use informal creditor agreements to ease their financial difficulties. The form of repayment agreement depends on a number of factors, including whether the financial difficulty is perceived as temporary, whether the vendors trust management, and whether the customer's lender is agreeable to a workout. In this setting, the vendor may still sell the customer on cash terms.

a. Individual Repayment Agreements, Discounts and Settlements

The debtor in financial distress and dealing with creditor delinquencies may elect to negotiate a settlement with each creditor. In this setting, those creditors that have the greatest leverage will get paid early and the largest percentage. Each creditor negotiates their own agreement with the debtor, although the debtor may insist on uniformity of creditor treatment.

Individual Repayment Agreement	Comment
Payment Over Time v. Lump Sum	Generally, repayment agreement provides for payment over time, at full contract rate.
Security Agreement for Vendor(s)	Depends on existing secured creditors.
Continued Sales	Can be tied to a buyer's premium to retire portion of debt.
Uniform Creditor Treatment	Generally not. Some vendors may have leverage for more favorable treatment.
Creditors' Committee	Generally not. Individual creditor action is common.
Automatic Stay	Does not apply.
Management in Control	Yes.
Sale of Assets	Generally management attempts to stay in control.
Disclosure of Financials/Liquidation Analysis	Debtor may provide to assist vendor to agree to repayment agreement.
Preference Risk	State preference laws not triggered.
Questionable Transactions Involving Insiders Investigated	Individual vendor generally does not investigate.
Involuntary Bankruptcy Alternative	Generally should not apply with debtor's cooperation to agree to repayment agreement.
Supervision of Court	No.
Claims Bar Date	No.

b. Collective Creditor Agreement

Here, the debtor has structured settlements with an entire class of creditors, say vendors and bondholders. Generally, the debtor sets a benchmark for acceptance by the creditor class, say a supermajority, or the debtor may be forced to sell all of its assets or liquidate.

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USING REPAYMENT AGREEMENTS IN OUT OF COURT WORKOUTS

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Collective Creditor Agreement	Comment
Payment Over Time v. Lump Sum	Generally, payment over time based on cash flow. May require discount.
Security Agreement for Vendor(s)	Generally depends on debtor's existing secured creditors.
Continued Sales	Individual vendor decision.
Uniform Creditor Treatment	Yes.
Creditors' Committee	Yes.
Automatic Stay	No.
Management in Control	Yes.
Sale of Assets	Generally management attempts to stay in control.
Disclosure of Financials/Liquidation Analysis	Creditor group will likely require.
Preference Risk	State preference laws not triggered.
Questionable Transactions Involving Insiders Investigated	Creditor group may insist on insider preference analysis.
Involuntary Bankruptcy Alternative	If debtor does not cooperate, or to preserve preferences, involuntary may be filed.
Supervision of Court	No.
Claims Bar Date	No.

c. Assignment of Security Interest to Creditors

In this setting, a third party acting on behalf of unsecured creditors, is granted a lien on all of the debtor's assets, junior to existing liens. For unsecured creditors, only those that agree to the security interest get the benefit of the lien. The lien secures payment of the unsecured creditors delinquent accounts. The creditors may foreclose on the lien in the event of a default by the debtor. The security interest discourages unsecured creditors from pursuing collection actions as any liens obtained come after the lien in favor of unsecured creditors. A creditors' committee may negotiate the lien.

Assignment of Security Interest to Creditors	Comment
Payment Over Time v. Lump Sum	Generally, payment over time based on cash flow. May require discount.
Security Agreement for Vendor(s)	Yes, junior to secured creditors.
Continued Sales	Individual vendor decision.
Uniform Creditor Treatment	For vendors that assent to lien.
Creditors' Committee	Yes.
Automatic Stay	No.
Management in Control	Yes.
Sale of Assets	Generally, management attempts to stay in control.
Disclosure of Financials/Liquidation Analysis	Creditor group will likely require.
Preference Risk	State preference laws not triggered.
Questionable Transactions Involving Insiders Investigated	Creditors may insist on insider preference analysis.
Involuntary Bankruptcy Alternative	Creditors ineligible as secured creditors.
Supervision of Court	No.
Claims Bar Date	No.

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USING REPAYMENT AGREEMENTS IN OUT OF COURT WORKOUTS

(Continued from page 10)

d. Receivership

Here, a third party, a receiver, acting on behalf of creditors, takes control of the debtor's operations. Receivership is a state court remedy available for creditors where the debtor has failed to pay. The state court appoints the receiver who is responsible for overseeing the assets and paying creditors. A vendor may reject a repayment proposal from the receiver and pursue collection on its own.

Receivership	Comment
Payment Over Time v. Lump Sum	Generally, payment over time based on cash flow. May require discount.
Security Agreement for Vendor(s)	No.
Continued Sales	Generally not.
Uniform Creditor Treatment	No required.
Creditors' Committee	Possible.
Automatic Stay	No.
Management in Control	No.
Sale of Assets	Possible that receiver arranges sale of assets.
Disclosure of Financials/Liquidation Analysis	Receiver may provide information to creditors.
Preference Risk	Possible, depending on the state.
Questionable Transactions Involving Insiders Investigated	Creditors may insist on insider preference analysis.
Involuntary Bankruptcy Alternative	Possible.
Supervision of Court	Yes.
Claims Bar Date	Yes.

e. Prepackaged Plan

If a debtor determines that it cannot reach consensus with its major creditors or creditor classes to permit an out-of-court workout, the debtor may resolve that a Chapter 11 is required. However, the debtor may receive some of the benefits of an out-of-court workout yet even with filing a Chapter 11 through a prepackaged plan. In this setting, a debtor may negotiate with its major creditor constituencies, such as bondholders and note holders, with hopes to reach agreement as to their treatment under a plan of reorganization. These prepetition negotiations may result in a consensus for treatment for all creditor classes, including vendors. The prepetition consensus results in a debtor's quick exit from Chapter 11.

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USING REPAYMENT AGREEMENTS IN OUT OF COURT WORKOUTS

(*Continued from page 11*)

Prepackaged Plan	**Comment**
Payment Over Time v. Lump Sum	Vendor claims may be paid through operations and ride through bankruptcy. Otherwise, may be lump sum payment or payment over time.
Security Agreement for Vendor(s)	Does not apply.
Continued Sales	Individual vendor decision. Bankruptcy Code provides administrative priority.
Uniform Creditor Treatment	Bankruptcy Code requires.
Creditors' Committee	Yes.
Automatic Stay	Yes.
Management in Control	Yes.
Sale of Assets	Prepack may provide for sale as part of the plan process.
Disclosure of Financials/Liquidation Analysis	Yes.
Preference Risk	Yes, per the Bankruptcy Code.
Questionable Transactions Involving Insiders Investigated	Yes.
Involuntary Bankruptcy Alternative	Does not apply.
Supervision of Court	Yes.
Claims Bar Date	Yes.

2. Liquidation

In this setting, the debtor will liquidate its assets, either through a sale of its assets, a secured creditor foreclosure, or an assignment of its assets.

a. Bulk Sale

The debtor is liquidating its assets and elects to sell all of its assets to a third party. Often a sale is orchestrated to an insider of the debtor or a friendly buyer. The sale is generally subject to the secured creditor's lien, and often there is an agreement with the secured creditor prior to the sale. A bulk sale is governed by state law, Article 6 of the Uniform Commercial Code, although a number of states have repealed their bulk sales laws. The bulk sales laws provide limited protections to unsecured creditors.

Bulk Sale	**Comment**
Payment Over Time v. Lump Sum	Lump sum. Distribution only after secured creditor (s) paid in full.
Security Agreement for Vendor(s)	No.
Continued Sales	Old customer gone. Opportunity for new customer.
Uniform Creditor Treatment	Yes.
Creditors' Committee	Possible. At the initiative of creditors.
Automatic Stay	No.
Management in Control	Through sale.
Sale of Assets	Yes.
Disclosure of Financials/Liquidation Analysis	Creditors must initiate.
Preference Risk	Depends on state law. 22 states have state preference laws. Courts split on enforcement of state preference laws.
Questionable Transactions Involving Insiders Investigated	Creditors must initiate. Creditor may have to fund.
Involuntary Bankruptcy Alternative	Creditors may commence if insider preferences and fraudulent conveyances are identified.
Supervision of Court	Yes.
Claims Bar Date	Yes.

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USING REPAYMENT AGREEMENTS IN OUT OF COURT WORKOUTS

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b. Secured Creditor Foreclosure and Sale

Here, a secured creditor forecloses pursuant to Article 9 of the Uniform Commercial Code. A secured creditor sale can be private or by public auction. A private sale generally is not advertised. Often, a private sale is to an insider of the debtor. Article 9 provides that a foreclosure sale must be done in a commercially reasonable manner.

Secured Creditor Foreclosure and Sale	Comment
Payment Over Time v. Lump Sum	Lump sum. Distribution only after secured creditor (s) paid in full.
Security Agreement for Vendor(s)	No.
Continued Sales	Old customer gone. Opportunity for new customer if foreclosure sale completed.
Uniform Creditor Treatment	Yes.
Creditors' Committee	Possible. At the initiative of creditors.
Automatic Stay	No.
Management in Control	Through foreclosure sale.
Sale of Assets	Yes.
Disclosure of Financials/Liquidation Analysis	Creditors must initiate.
Preference Risk	Generally not.
Questionable Transactions Involving Insiders Investigated	Creditors must initiate. Creditors have to fund.
Involuntary Bankruptcy Alternative	Creditors may commence if collusive foreclosure or insider transactions identified.
Supervision of Court	Yes.
Claims Bar Date	No.

c. Assignment for the Benefit of Creditors

In this setting, a liquidation where third party, an assignee, takes title to all of the assets and liquidates them for the benefit of creditors. The proceeds from the assignment are distributed based on priority of claims. Often, an assignment is followed an immediate sale to a third party, often an insider of the debtor.

Assignment for Benefit of Creditors	Comment
Payment Over Time v. Lump Sum	Lump sum. Distribution only after secured creditor (s) paid in full.
Security Agreement for Vendor(s)	No.
Continued Sales	Old customer gone.
Uniform Creditor Treatment	Yes.
Creditors' Committee	Possible. At the initiative of creditors.
Automatic Stay	No.
Management in Control	Through sale.
Sale of Assets	Yes.
Disclosure of Financials/Liquidation Analysis	Creditors must initiate.
Preference Risk	Depends on state law. 22 states have state preference laws. Courts split on enforcement of state preference laws.
Questionable Transactions Involving Insiders Investigated	Creditors must initiate. Creditor may have to fund.
Involuntary Bankruptcy Alternative	Creditors may commence if insider preferences and fraudulent conveyances are identified.
Supervision of Court	Yes.
Claims Bar Date	Yes.

(*Continued on page 14*)

USING REPAYMENT AGREEMENTS IN OUT OF COURT WORKOUTS

(*Continued from page 13*)

E. Reform Act Impact on Debtors May Mean More Repayment Agreements for Vendors

Given the increased risks of liquidation that a Chapter 11 debtor now faces as a result of the Reform Act, as well as the greater restraints imposed on Chapter 11 debtors, the customer in financial difficulty will consider financial restructuring alternatives to Chapter 11.

In a workout setting, the creditor may agree to work with the customer and to take payment over time on the delinquent account. The rescheduling of the payment obligation may be formalized in a Repayment Agreement or Restructuring Agreement (RA). The RA specifies a payment plan with the delinquent account, for example, repayment over six months, amortized monthly. The vendor may insist on security, such as a junior secured claim in all assets, or, if the delinquent account is with a corporation or LLC, a personal or corporate guarantee.

The RA is treated as an unsecured claim in bankruptcy. This means that the vendor will be classed with other unsecured creditors under a plan of reorganization in a Chapter 11. The vendor will receive a percentage payment on account of the RA.

1. Collection Suit Alternative

If the customer fails to pay on an open account, a vendor must consider its alternatives to collect on the account, including a collection suit. In a workout setting, as opposed to where the debtor intends to liquidate its assets, the vendor may sue and seek an interim remedy such as a writ of attachment. However, the risk with this strategy is that an aggressive vendor, in certain situations, could trigger other vendors commencing suit in a race to the courthouse, and, perhaps, force a bankruptcy filing. Given this risk, the vendor may opt to work with the customer.

2. Common Terms of Repayment Agreement

a. Fix Amount Owed

The RA allows the vendor to fix the amount owed, including fixing the amount of customer concessions and disputes. By fixing the amount owed allows the vendor avoid later disputes as to application of payments and customer concessions.

b. Waiver of Any Disputes

The RA protects the vendor from later challenges by the customer that an amount is in dispute, that the product or service provided is defective, that the documentation supporting the debt is incorrect. The debtor waiving any defenses allow the debtor to promptly proceed to judgment should the debtor default on the RA

c. Fix Repayment Schedule

The RA should provide a fixed schedule for repayment of the debt. The repayment schedule may be on a monthly basis. The benefit of the fixed schedule allows the vendor a clear timetable for repayment of the delinquent account, in contrast to a mere understanding that the debtor will pay when it may have free cash.

d. Security Interest

To back up the RA, the vendor may insist that the debtor grant a junior security interest in all of the debtor's assets. Whether the debtor will grant such an interest will depend on the debtor's existing inventory lender's consent, as well as the debtor's perception of other vendors reaction to granting a security interest.

e. Personal Guarantee or Corporate Guarantee

To back up the RA, the vendor may insist that the debtor's principal, if it is a small business, personally guarantee the past due debt, as well as any future sales on credit. The personal guarantee is an inducement by the vendor not to take any creditor collection action, and, perhaps, afford continued sales. Of course, the principal may reject the guarantee request, or limit the amount of the guarantee.

Should the debtor have a related corporation, the vendor may look to the related corporation to provide a cross-guarantee to back up the RA.

f. Continued Sales with Premium

As part of the RA, the debtor may insist that the vendor continue to sell the debtor. The vendor may agree to continued sales, but on cash terms. The vendor may also consider including a premium above the invoice price to retire a portion of the delinquent account.

3. Restructuring Agreement May Help Beat Preference

Even though the customer may enter into the RA, and honor the payment terms of the RA, the customer may still be forced to file bankruptcy. Are the payments received by the vendor under the RA during the 90 day prior to bankruptcy a preference? The vendor's defense to the preference demand is that the RA has replaced the delinquent open invoices. Therefore, if the debtor paid according to the terms of the RA, the vendor may contend such payments were ordinary course under section 547(c) of the Bankruptcy Code and conformed with the RA.

F. Repayment Agreement May Help Collect Delinquent Account And Minimize Preference Risk

Given the changes to the Bankruptcy Code as a result of the Reform Act that prefer certain creditors, as well as the additional constraints imposed on the debtor, vendors may expect more customers to attempt to work out their financial difficulties through out-of-court alternatives. Get your repayment agreement ready!

RELEASING YOUR LIEN AS A PREFERENCE DEFENSE: STEPS TO PRESERVE THE DEFENSE

(*Continued from page 5*)

he *JWJ Contracting* decision highlights that the a subcontractor needs to confirm that before an unconditional lien release is signed, whether on a public or a private project, the vendor should ensure that the check has cleared, if that is the form of payment. With the check cleared, followed by release of lien, the subcontractor may preserve its preference defense. Likewise, the subcontractor should confirm the amount of claims against the bond prior to releasing the lien to confirm availability for payment.

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