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THE TRADE VENDOR QUARTERLY

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

ENCOURAGING YOUR CUSTOMERS TO PAY THROUGH PROVISIONS IN CREDIT DOCUMENTS

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Customers failing to honor a vendor's credit extensions are on the rise as the economy slows. Given the increase in customer defaults on credit sales, what terms and condition may a vendor include in their sale documents, including credit application, vendor contract, invoices or order acknowledgements that may prompt a customer to honor the credit sales, or promptly pay when the customer fails to honor the extensions of credit? Some terms a vendor may consider including in its documentation that may prompt the customer to honor the credit terms is considered below.

Contract With Your Customer

For vendors selling goods, Article 2 of the Uniform Commercial Code governs the rights and remedies of a buyer and seller with the sale of commercial goods. Article 2 provides that with the sale of goods over $500, there must be a signed writing. A signature certifies the writing for the sale of goods. With the traditional sale of goods over $500, the credit executive may memorialize the credit documentation through a signed credit application and invoices or order acknowledgments. If the customer refuses to sign a credit application or supply contract, the vendor generally will have a binding contract with the customer through purchase orders and corresponding invoices or order acknowledgments.

Likewise, where the vendor documents the sale electronically through a credit application posted on its webpage, or confirming electronic invoices or electronic order acknowledgement, under the federal digital signature act, a vendor may have a binding contract.

Encouraging Your Customer To Pay Through Credit Documents

Attorney's Fees and Costs

Attorney's fees can be recovered from the customer as costs of a collection suit when there is an express provision in the credit application or supply contract that provides for the recovery of fees and costs. Common language is:

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

The court has discretion to determine the amount of fees and costs to award. If the vendor does not have such a provision, the general rule is that the vendor is not entitled

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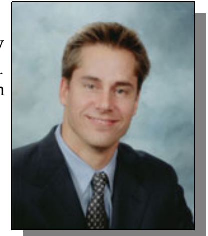
BANKRUPTCY CASES ARE ON THE RISE, THEREFORE SO ARE PREFERENCE ACTIONS: PREPARE YOUR DEFENSES



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Bankruptcies are dramatically on the rise, as shown by recent statistics. For example, 2008 first quarter business filings are up 38.7% over 2007 and up 113% over 2006. 2008 Q2 filings are up 45.3% over Q2 2007 and 101% over the second quarter in 2006. With the spike of bankruptcy filings, whether chapter 7, 11, or 13, comes more bankruptcy preference actions that vendors must be prepared to defend.

The Preference Action

The Bankruptcy Code empowers the debtor, or trustee if one is appointed, to avoid transfers of assets and monetary transactions prior to a bankruptcy filing. The Bankruptcy Code defines preference expansively to include nearly every transfer by an insolvent debtor 90 days prior to filing for bankruptcy.

The power to avoid a preferential transfer is one of the most powerful weapons that a debtor or a trustee can use. However, not all transfers made in the 90 days prior to the filing of bankruptcy are avoidable. There are multiple strategies that may be employed to attempt to defend against a preference action.

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HAVE YOU SHIPPED GOODS TO AN INSOLVENT BUYER? NO NEED TO FEAR, RECLAMATION LAWS ARE HERE.

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The situation is too familiar for many vendors. Goods are sold to an insolvent buyer, and that buyer subsequently files for bankruptcy. The bankruptcy process may or may not provide some payment to vendors for the goods delivered to the now bankrupt buyer. It is common for vendors to ultimately see pennies on the dollar recovered through a bankruptcy. There is a silver lining for vendors that find themselves in this situation. The law provides these vendors with avenues to lessen or in some cases to prevent the losses that are coupled with selling goods to an insolvent buyer.

Stopping Goods in Transit

Vendors may find themselves in the position of having agreed to sale goods to a buyer, that later turns out to be insolvent, and the goods have not yet been delivered to the buyer. In such a case, the vendor may be able to refuse to deliver the goods, or, if the goods have already been placed in transit, the vendor can stop the goods from being delivered while in transit.

Vendors, if certain conditions are met, may stop goods in transit before they are delivered to an insolvent buyer and either refuse to deliver them at all or demand cash payment for delivery. The critical element in this setting is that vendors must still be in possession of the goods. The goods may still be in the vendor's possession, in transit to the buyer with a carrier, or at a warehouse ready for pick up by a buyer. The second element is that the buyer must be insolvent before the goods are delivered. The definition of insolvency depends on whether the buyer has filed bankruptcy. Absent a bankruptcy filing, the Uniform Commercial Code's definition of insolvency is what is used. The Uniform Commercial Code's definition of insolvency differs depending on jurisdiction. However, there are two common definitions used; equity and balance sheet. Under the equity approach, a buyer is insolvent when it is unable to pay its debts as they come due. Under the balance sheet approach, a buyer is insolvent if its liabilities exceed the fair market value of its assets. If the buyer has filed bankruptcy, the balance sheet definition of insolvency is used. As long as the two conditions of possession and insolvency are present, vendors can protect themselves from a credit sale to an insolvent buyer by refusing to deliver to the insolvent buyer.

Stopping goods in transit prevents those goods from reaching an insolvent buyer, and a vendor from finding themselves in the position of having to implement collection efforts for payment. If a buyer has filed for bankruptcy the goods may be stopped in transit, and this has been held not to violate the automatic stay against collective efforts which is triggered with the filing of a bankruptcy.

Reclamation

In the case that the goods have already been delivered to the buyer, vendors may have another route at mitigating their damages. The U.S. Bankruptcy Code provides that under certain situations a vendor may reclaim goods sold to a buyer that has filed for bankruptcy. Goods may be reclaimed under the Uniform Commercial Code as

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FROM THE PUBLISHER:

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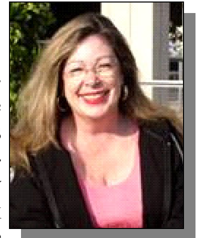
Guest Column

SELLING TO THE FINANCIALLY TROUBLED CUSTOMER—WARNING SIGNS

Virginia Soderman, CCE



In the volatile economic environment we are now experiencing, there is no margin for error in identifying potential insolvency situations. Identifying weak customers is one step in the path to a healthy receivables portfolio. Once identified, the question becomes how to protect your company's investment.

This article will provide you with many areas to review and analyze before making a credit decision. However, once a new customer has been approved, the review and analysis should not stop. In a fluid economic environment, let alone the volatile environment we are now experiencing, circumstances change and the alert vendor not only sees the changes, but makes the necessary modifications to protect the supplier's investment. Modifications to the existing relationship may be all that is necessary, but there are times when it is prudent to withdraw credit and sit on the sidelines. Each company will have internal considerations in the decision to withdraw from a selling relationship, versus continuing to sell and taking a risk regarding a potential loss. Many considerations such as post-insolvency shelf space for a retailer or relationship issues, etc., will dictate any single company's response to a potential insolvency situation. However, as Credit Professionals, it is paramount to identify the potential problem and determine alternatives; communicate the risk and take steps to avoid the loss.

IDENTIFY THE WARNING SIGNS

Warning signs or Red Flags come in many forms. They can be more difficult to spot with the privately held company, versus the publicly held company. But even with the privately held company, manifestations of financial or market problems can be found if approached from a global point of view.

Always start with a common sense macro view. Is this customer involved in an industry that is experiencing market pressure? For example, with the current decline in real estate values, many property owners perceive a loss of wealth. Although it may be a paper loss, the changing mind set will impact behaviors. In this setting, if your customer or

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FAIL TO OBJECT TO RELEASE PROVISION IN A CHAPTER 11 PLAN MAY RESULT IN LOSING YOUR PERSONAL OR CORPORATE GUARANTEE

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A credit executive looking to reduce credit risk in today's uncertain economic environment may look to a credit enhancement to assist in making the sale on credit terms. A credit enhancement commonly considered by a vendor is a personal or corporate guarantee. Some of the reasons a vendor may prefer a guarantee to other enhancements (such as Article 9 security interests) include generally not needing the consent of the debtor's lender, and no notice requirements to other vendors that the debtor is buying from. The purpose of the guaranty is straightforward: should the primary obligor, your corporate customer, fail to pay, you have a second pocket for payment(secondary liability). This promise to pay by the guarantor is an inducement for you to sell the corporate customer on terms.

What is the impact on your guarantee (personal or corporate) when the primary obligor, your corporate customer that received your product or service on credit terms, files Chapter 11? May the personal guarantor who is an officer of the Chapter 11 debtor and responsible for running the business, obtain an injunction from the bankruptcy court to prevent you from collecting on the delinquent account during the pendency of the Chapter 11? Can the Chapter 11 debtor confirm a plan of reorganization that bars you from collecting against the guarantor? The bankruptcy court in In re Dr. Barnes Eyecenter, Inc., recently ruled that a debtor could confirm a plan that bars a creditor from collecting from the guarantor.

A Guarantee to Pay

A key element of guarantee law is that the guarantor is not a party to the principal debt. The guarantor's undertaking is independent of the primary obligor, your customer, promise to pay. Merely because both contracts are on the same paper − your customer's promise to pay for the goods or services, and the guarantor's promise to pay if your customer does not -- does not change the independence of the agreements. However, the relationships between the customer and guarantor are intertwined. As the case discussed below highlights, a vendor must be vigilant as to its collection rights against its guarantor when the primary obligor attempts to use bankruptcy to assist a guarantor in escaping liability.

A Primary Obligor's Bankruptcy Filing

Where you have sold your customer product or service on credit terms, that customer, as the primary obligor, has a contractual duty to pay. If the customer fails to pay, the vendor may sue either the customer or the guarantor. However, should the customer file Chapter 11, the vendor's right to collect on the delinquent account are limited.

The Automatic Stay

Should the customer file Chapter 11, the vendor must cease all efforts to collect against the customer, the primary obligor, because of the automatic stay. The automatic stay is an injunction which automatically and immediately goes into effect as soon as a bankruptcy case is filed, whether the bankruptcy filing is one under Chapter 7, 11 or 13. The stay is automatic in the sense that it arises upon filing the bankruptcy case by operation of law, without the bankruptcy court having to enter an order stating that it exists. The stay is in effect even where the creditor has not been given notice that the bankruptcy case has been filed.

The automatic stay prohibits any creditor from taking action against the property of the estate and against the debtor, unless relief from stay is obtained. The purpose of the automatic stay is to give the debtor breathing room, and to protect creditors from each other by preserving the bankruptcy estate intact until property can be distributed according to the bankruptcy priority scheme and allow orderly administration of the case.

Does the Automatic Stay Extend to the Personal Guarantor?

May the personal guarantor use the automatic stay of the primary obligor, your customer that received your product or services, as a shield to stay efforts to collect from the guarantor? A personal guarantor may request the bankruptcy court stay the efforts of the vendor to collect on the guarantee during the time in which the guarantor attempts to assist in reorganizing the Chapter 11 debtor, whose debt he or she has guaranteed. The common setting for this request is when the personal guarantor is providing management services to the Chapter 11 debtor and those services are integral to the debtor's ongoing operation. The guarantor argues for injunction on the basis that to respond to the creditor's collection suit could result in a loss of value of the debtor's operations. The minority of courts that agree to enjoin the guarantor's efforts to collect limit the injunction until a plan has been confirmed.

May a Chapter 11 Plan Bar Collection on the Guarantee

Unlike the point above where the guarantor attempts to limit the creditor's right to collect on the guaranteed debt only during the pendency of the Chapter 11, in the case of Barnes Eyecenter, the debtor sought to bar the creditor's right to collect against a guarantor forever. In Barnes Eyecenter, the primary obligor was a retailer, and a lease was guaranteed by a related company. The retailer filed Chapter 11, and eventually confirmed a liquidating plan. A provision of the liquidating plan allowed for the discharge of the corporate guarantee. The provision in the plan that the creditor later challenged, sets forth:

Any claims held by Debtor's insiders, including but not limited to Debtor's affiliate . . . shall be subordinated to the claims of all other creditors of . . . estate, and no distributions shall be made on account of same until all other claims are paid in full pursuant to this Plan. In return for the subordination of their claims, Debtor's Insiders shall not have or incur any liability to any person for any claim, obligation, right, cause of action or liability, whether known or unknown, foreseen or unforeseen, existing or hereafter arising, based in whole or in part on any act or omission, transaction, or occurrence from the beginning of time through the Effective Date in any way relating to DBEI, its Bankruptcy Case, or the Plan; and all claims based upon or arising out of such actions or omissions shall be forever waived and released.

The creditor holding the guarantee did not object to the discharge of guarantee provision in the plan. The creditor sued the guarantor to collect for the primary obligor's debt. The guarantor sought dismissal of the collection suit contending that the

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to its fees and costs and must bear those costs.

Interest and Late Fees

Like an attorney's fee provision, a vendor may include an interest provision if a customer fails to pay pursuant to the credit terms. Common language is:

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

If the vendor does not have an interest provision in the credit application or supply contract, vendor contract or invoice, then a court may decide not to award interest to the vendor from the date of the breach. If a court awards interest, then it is usually at a lower interest.

Waiver/Duty to Inspect

The vendor may use its credit application or supply contract to prompt a customer to complain of any problems with the product shipped. To that end, the vendor may include a provision in its credit application or supply contract that requires the customer to investigate the product, as well as the documents that support the sale, and complain within a reasonable period. Common language is:

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

Key to imposing on the customer a duty to inspect is that if the customer fails to complain within the period set forth in the credit application or supply contract, the customer loses its right to later complain and legally withhold payment for the order. As with the other provisions noted above, if the vendor refuses to sign the credit application or supply contract, this term may be challenged by the customer if later included in the vendor's invoice. The battle of the form doctrine, which addresses this defense, is considered below.

Venue

For the vendor selling the out-of-state customer, the location of resolving the dispute may make a difference as to promptly resolving the dispute. If the vendor has a provision in the credit application or supply contract that sets out that disputes will be resolved in the vendor's local venue may prompt the customer to pay. Common language is:

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

Arbitration

As an alternative to filing a lawsuit to collect on the delinquent account, the vendor may elect to arbitrate the delinquent account, provided the vendor has an arbitration clause contained in its credit application or supply contract. Common language is:

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

Like the terms and conditions above, an arbitration fee provision can prompt a customer to pay when the customer fails to honor the credit terms. The vendor can invoke the arbitration provision upon the customer's demand by sending a demand letter coupled with an arbitration form. However, if the customer has not agreed to the arbitration provision through the credit application or vendor contract, but rather the arbitration provision is contained in the vendor's invoice, the arbitration provision may be unenforceable. The legal doctrine that the customer may use to block the enforceability of the arbitration provision is the battle of the forms doctrine. This doctrine may also be used by a customer to block a vendor's efforts to enforce an attorney's fees and late fees provisions that may be set out in a vendor's invoice.

Battle of the Forms

In some settings, a customer may refuse to sign the vendor's credit application or supply contract. In this setting, the vendor may ship on credit terms based on the customer's purchase orders. The vendor matches the customer's purchase order with an invoice that sets out favorable terms for the vendor, such as attorney's fees, late fees and arbitration provision. However, if the customer's purchase order contains terms that conflict, which provision controls?

The general rule provides that a written confirmation, such as invoice, which is sent within a reasonable time operates as an acceptance even though it states terms additional or different. The additional terms are to be construed as proposals for additions to the contract, and between merchants, vendor and customer, such terms become part of the contract unless: (a) the offer, the purchase order, expressly limits acceptance to the terms of the of the offer; (b) the terms of the invoice materially alters the purchase order; or (c) the customer notifies the vendor, or vendor notifies the customer, that the new terms are objected to within a reasonable time. This means that in those settings where the customer refuses to sign the credit application or supply contract which contains the provisions that may encourage the customer to pay, the vendor must review the customer's purchase order to ensure that the customer does not include a provision that may bar the vendor's provisions that may encourage the customer to pay.

Take Away

A credit application can be central to setting forth the rights of the vendor in the event of a dispute with the customer. A credit professional may limit credit risk and address contingencies with an effective terms and conditions section of a credit application or supply contract, and therefore the vendor may refuse to extending credit terms without the customer agreeing to the credit application or supply contract.

BANKRUPTCY CASES ARE ON THE RISE, THEREFORE SO ARE PREFERENCE ACTIONS: PREPARE YOUR DEFENSES

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Common Vendor Defenses

The three most common vendor defenses that are employed are ordinary course of business defense, the contemporaneous exchange defense, and the new value defense.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) has made it easier for vendors to keep transfers made by debtors in the ordinary course of business. The ordinary course of business defense is the most commonly asserted defense by trade vendors. The defense protects payments made to unsecured vendors that fall within the 90 days prior to bankruptcy, where the vendor is able to establish that the payment is ordinary as between the parties or that the payment is ordinary in relation to prevailing business standards.

To determine whether the payments are ordinary, a court will look to the preexisting relationship between the parties to determine if the transfer is outside the ordinary course of business. Secondly, the court can look at the industry in general to determine if the transfer could be deemed ordinary, including transfers made from debt restructuring agreements.

Other common statutory tools, which remain unaffected by the BAPCPA that can be used are the contemporaneous exchange and new value defense. The contemporaneous exchange defense excuses any payment or other transfer that the debtor and vendor had intended as a contemporaneous exchange and was, a substantially contemporaneous exchange. The subsequent advances, or new value defense, applies after a preferential transfer, the vendor gave new value (inventory).

Prepare Your Plan

To successfully defend against a potential preference action, a vendor should prepare payment history for 12 months before the debtor filed for bankruptcy, a history of shipments to the debtor 90 days before the bankruptcy filing, invoices for payments issued during the preference payments, and all correspondence with the debtor a year before the preference period begins. The above mentioned material will allow a vendor, or its attorney to prepare an effective response when a demand letter is received.

Helping You Keep Your Money

Looking at recent history, our firm has seen successes in representing vendors who have received transfers from debtors in cases are subject to avoidance under preference actions.

Over roughly the last four-year period, figures of cases defended by our firm show that over $23 million has been demanded in preference actions. In representation of our clients, we have been able to settle those cases for a fraction of the amount demanded, $2.83 million, or roughly 12 percent of the demanded amount. That is a savings of nearly $20.5 million dollars of the overall demanded amount.

HAVE YOU SHIPPED GOODS TO AN INSOLVENT BUYER? NO NEED TO FEAR, RECLAMATION LAWS ARE HERE.

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well, but this article will focus on reclamation rights in the bankruptcy setting.

Pursuant to § 546(c) of the Bankruptcy Code, a seller of goods may reclaim goods received by the debtor within 45 days of the filing of the bankruptcy petition when those goods are sold to the debtor in the ordinary course of business. The vendor must make a demand for the goods within 45 days of the receipt of the goods by the debtor, or no later than 20 days after the filing of the bankruptcy petition. Although some courts have held that this demand may be made orally, it is advisable that the demand be made in writing. Most of all, a written record of the demand gives the vendor an easy path to proving that demand was made and what was included in that demand.

An important element of reclamation that is often overlooked is that the debtor must still be in possession of the goods at the time the demand is made. If the goods have already been sold at the time the demand is made, the vendor has no reclamation rights regarding those goods under§ 546(c) of the Bankruptcy Code. The burden of proof of possession of goods is on the vendor; therefore, it is advisable that the vendor visit the debtor's premises immediately at the time the demand is made to take an accounting of the goods on hand.

Once a valid reclamation demand is made, the debtor must return the goods. If the goods are sold after the demand is made, or at the election of the vendor and the debtor, the vendor may be given an administrative claim in the bankruptcy for the value of the goods subject to the reclamation demand.

Even more potent, the Bankruptcy Code, under § 503(b)(9), provides that goods sold to a debtor within 20 days of the filing of the bankruptcy petition gives the vendor an administrative expense priority claim. This gives the vendor priority of payment over most other unsecured creditors. No proof of the goods on hand needs to be made. It is sufficient that demand be made in the bankruptcy under this section.

An interesting issue is whether a party should also file a motion for injunctive relief with the reclamation demand to prevent the selling of the goods. A search of any jurisdiction's docket will reveal a mixed bag of reclamation demands filed with and without prayers for injunctive relief. There does not appear to be a requirement of coupling injunctive relief with a reclamation claim demand. However, it seems to make clear sense to seek injunctive relief if return of the goods rather than an administrative claim is what is being sought.

Conclusion

It is important that vendors understand that time is of the essence when a buyer files for bankruptcy. Two of the more powerful collection tools for vendors are stopping goods in transit and reclamation. However, these remedies require that the vendor not sit on their rights, and take an aggressive stance in implementing these tools. Likewise, the wisest vendors will ensure that accountings of goods delivered to a buyer that has filed bankruptcy will be done quickly. Waiting for the courts to order accountings may affect a vendor's ability to prove that goods were on hand.

Guest Column

SELLING TO THE FINANCIALLY TROUBLED CUSTOMER—WARNING SIGNS

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prospective customer is involved in building, or related trades, the near term prospects are likely to be dim. If consumers perceive a decline in wealth, it is typical for them to restrict spending. Therefore, even home improvement businesses are likely to see a drop in revenue. Although there will always be exceptions to the rule, in general, a macro view of the industry challenges will reveal much about your customer's potential. A good general rule of thumb is if your customer provides a nonessential product or service, they will be impacted negatively by the current economic environment. Conversely, firms who supply essential goods and services may experience economic pressures, but the downside risk is less dramatic.

Red Flags come in many forms and for the purposes of this paper; we will categorize them in three major categories: Market Driven, Financial and Personnel.

MARKET DRIVEN

A. Prospects for near term profits dim: Regardless of a firm's efficiency, a drop in demand for the goods or services provided is an early warning sign of troubles to come. As performance is monitored over the ensuing months, keeping an eye on the conditions that prompted the decline in demand will shed light on your customer's need to take further action. Whether or not the actions are taken will tell if this firm will survive the downturn. Ask yourself if there are competitors that are cannibalizing sales from your customer. In difficult market conditions, if demand is down in the category or market segment, then the next best strategy is to steal competitors' sales.

B. Stock & Bond pricing: For a public company, the fluctuation in stock price is the best indication of a composite view of the customer. Not only will the stock price reflect the financial condition of the company, but the market tends to integrate the overall short term prospects in the relative price of the stock. For firms with publicly traded debt, many of the same inferences can be drawn. There are many resources and indices available to track the stock and public debt of a firm and they can be used for notification of major swings in prices or value.

C. Key customer losses: When evaluating your customer, it is often prudent to review your customer's customer. A large loss within your customer's receivable portfolio can easily trigger cash and profitability ripples that can be devastating to your customer's financial condition. Publicly traded companies generally publish information regarding the concentration of sales to a single customer or group of customers. As part of the review of a private company, it is highly appropriate to request and consider the concentration of sales amongst a single customer or group of customers. Diversity in the customer base helps to minimize the impact of a single customer's actions or condition. A concentration of upwards of 20% is oftentimes a significant basis for concern.

D. Increase in credit reference requests: At times, a firm may increase the number of vendors they purchase from in order to stagger purchases and allow them more time to pay for product, before placing another order. An increase in credit rating requests can easily be a warning of this type of activity. Membership in a Credit Interchange Group, which includes a wide assembly of your own competitors helps to identify this pattern and anticipate your customer's next move.

FINANCIAL

A. Financial results are declining: Where Financial Statements are available, there are a number of comparisons that can be made which will make the financial problems visible. Reduced cash, increased inventories (when not seasonally required), reduced lending line availability, reduced EBITDA, decline in Interest Coverage, all can provide insights into the overall condition of the company and its future prospects.

B. Inconsistent Financial Information: When dealing with a privately held company, often times financial statements are provided to a vendor. When they are provided, changes in the firm who does the auditing can be an indication of management's dissatisfaction with the Audit Team's recommendations or reservations. A customer who declines to provide financial information, but has always provided financial statements on a quarterly or annual basis in the past, creates a reasonable basis for concern as well. It is prudent to understand the reasons for the changes and to evaluate the validity of what has been stated as to the reasons for the change.

C. Days Payable Outstanding: When financial statements are available, the change in Days Payable Outstanding is a clear indication of a company attempting to increase vendor financed inventories, which can be an early warning sign of problems. Even for the privately held firm, watching overall trade payments can give an indication of cash availability and possible other priorities for cash or lack thereof.

D. Cash burn rate: In situations where financial information is provided, it is easy to determine how quickly the company is using cash. Analysis of how long the cash reserves and credit line availability will last in light of the rate of use of cash, or cash burn rate, can give good insights into how long your company may be able to sell to this customer before cash flow becomes problematic.

E. Sources of financing impediments: Where the debt is public, or where you are in touch with your customer's bankers, it is possible to be aware of loan covenant violations. When these occur, a good indication of the lending institutions comfort level is how quickly the covenant is waived and for how long. A lender, who is no longer comfortable with the credit outstanding, will not waive the covenant, or only waive it long enough for your customer to attempt to find another lender. Other warning signs with the lender might be the switch from an unsecured facility to a secured facility or shortened term as opposed to the previous renewal.

F. Letter of Credit Facility: When a Letter of Credit facility is attached to a lending relationship, it is important to watch for a change in that facility. Letters of Credit can often times be outstanding for months at a time. If a lender is cutting short or eliminating that aspect of the relationship, it could be an indication of the lenders unwillingness to stay with the client for the long term.

G. Vendor or Factor withdrawal of support: Whenever a factor or Vendor withdraws support, a source of credit availability is no longer available to your customer. The increased cash requirements of paying Cash in Advance for shipments or waiting for receivables to be paid, rather than gaining cash immediately from the sale of the receivables, limits your customer's cash and creates internal financing difficulties for day to day operations. The warning signs are becoming more serious.

H. Cyclical Cash: Certain times of the year can be times when a cash build up is expected. For example, a retailer who usually has the most cash right after Christmas.

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Guest Column

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If your customer is not paying timely during a season when cash should be ample, a clear warning sign exists and should be researched.

I. Lawsuits: Whether your customer is public or private, lawsuits are considered public information and there are a number of sources that will monitor legal activity for you. Occasional lawsuits are considered routine in most industries; however lawsuits for collections are worth looking into. A single suit may be the result of a dispute, but multiple lawsuits for collection usually mean your customer is under significant stress.

J. Returned checks: Here, the warning signs are getting stronger. If your customer is unable to fund checks that have been written, there is a serious cash availability concern. Whether it is related to a lender's retraction of a line, or reduced cash flow from reduced sales, flexibility is seriously reduced. A firm in this situation is not likely to be able to cope with any adverse condition that may arise.

K. Tax liens: Occasionally, a small tax lien can occur and it is nothing more than an oversight. However, once a customer has any significant tax liens filed against them, the situation is serious and time may be getting short to improve the situation. The situation is getting more intense and the firm is dealing with many issues in its attempt to survive.

L. Moratorium/Payment Plans: As financial conditions deteriorate, a customer may approach your company to devise a payment plan. If the situation is more serious, the customer may announce a moratorium on all payments for past goods or services and propose that those debts be set aside while the company works to address the problems. At this point, there is no more business as usual. Each step taken must be analyzed to determine its impact on your customer's financial condition as well as the results for your own company.

M. Assignment for the Benefit of Creditors or Bankruptcy filing: The warning signs are over. The customer is now attempting to either reorganize or liquidate. Your responsibility now shifts to maximizing your company's return on the debt. Although circumstances may dictate that you continue to sell, you will need to find remedies that will allow you to sell with minimized risk factors.

PERSONNEL

A. Senior staff resignations: Oftentimes one or many senior staff members resign from an organization when they see from internal observation that future prospects for the firm or themselves are dim. Private or public, it is generally possible to keep informed on the senior staff names and movement. For a public company, watching SEC filings relating to stock options programs etc. can provide some insight into senior management's incentives and priorities.

B. Senior Management stops communicating: Communication is one of the keys to smooth credit relationships. When results are favorable, communication is easy. However, when results start to falter, it is often a challenge for management to address it directly. As a result, communication will frequently slow down or stop; calls are not returned or emails go unanswered. This change in communication patters is oftentimes is an indicator of a negative trend and needs to be noted and addressed directly.

C. Employee rumors & departures: As tensions build in a troubled company, employees notice the change. Rumors start that may not have a lot of factual material, but the tone has been captured and employees react. Key employees, who are not senior management can get nervous and decide to make a change. When situations are really difficult, it is not unusual for a payroll to be late or for payroll checks to be returned. Those occurrences prime the rumor mill pump and add more pressure to those who are considering making a change. When a Collector calls for the Controller and he or she is "no longer with the company", it is worth finding out a little more information. This may be a warning sign that is not going to make it into the press, but it is still significant for your company and your relationship with the customer.

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FAIL TO OBJECT TO RELEASE PROVISION IN A CHAPTER 11 PLAN

(Continued from page 3)

Chapter 11 plan barred the creditor from collecting on the guaranteed debt. The creditor responded complaining that the discharge provision contained in the plan was not specific.

The court found that the release of claims contained in the Chapter 11 plan was a key part of the bankruptcy order confirming the plan and the guarantor was specifically mentioned. The release of claims was not simply boilerplate language the court noted, but rather a necessary part of the plan. The creditor was barred from collecting on the guaranteed debt.

Lessons Learned

In today's uncertain economic climate, personal and corporate guarantees can be integral to the credit decision making to approve credit terms in making the sale, as the guarantees reduce or eliminate credit risk. However, the court's reminder is that should your customer, the primary obligor, file Chapter 11, you must be vigilant. The goods news for vendors is that the general rule is that bankruptcy courts will not permit Chapter 11 debtors to release guarantee claims, where an objection is lodged. However, it is up to the vendor to object to the release provision contained in the debtor's plan provision. Absent the vendor's objection, the release provision may ride through the plan process and allow to stand should the vendor sue the guarantor to collect on the debt.

To underscore, in a Chapter 11 setting, the debtor may launch a rear-guard action on behalf of the personal guarantor, who is often an officer of the debtor, to defeat the creditor's right to collect on the guarantee. A vendor must closely review the debtor's plan of reorganization and disclosure statement. The disclosure statement may contain a release provision such as the one set out in Barnes Eyecenter, or a form such as: "the confirmation of the Plan releases any guarantees of collection or obligations arising out of undertakings made or given by third parties . . . ." By being vigilant and objecting to such guarantee release provisions, the vendor can look to the guarantor's pocket and reduce the risk of loss.

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