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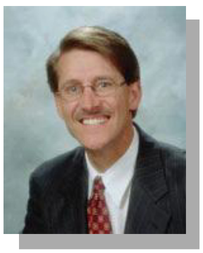
THE TRADE VENDOR QUARTERLY

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

COMMERCIAL CREDIT AND THE RECESSION: COLLECTING ON YOUR DELINQUENT ACCOUNT (AND PRESERVING THE TRADE RELATIONSHIP) USING A REPAYMENT AGREEMENT



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Chapter 11 filings and out-of-court workouts and liquidations are on the rise as a result of a downturn in the economy. Companies that are weathering the downturn and are able to avoid more formal restructurings, may find themselves failing to honor their trade terms with vendors because of the freeze in the credit markets and downturn in customer demand.

However, in a recessionary economy, the credit professional cannot merely cut off credit when a customer fails to honor its credit terms. The focus of the credit professional is no longer merely collection alternatives as a substitute customer can be found in a robust economy. Rather, the credit professional must evaluate, with the assistance of sales and management, credit risk for future sales even where a customer has past due invoices.

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In this recessionary setting, the credit professional must create the documents that create the greatest leverage for payment on the delinquent account and minimize any later disputes as to balance owing, pay down and payment method. Rescheduling the past due invoices into a formal repayment agreement may be an essential document for the credit professional for payment on the past due invoices and the expectation for future sales in a recessionary economy.

A. The Repayment Agreement and Due Diligence

In assessing the prospects of a repayment agreement as a method to cure the delinquent account, as opposed to litigation alternatives, the vendor must determine the customer's willingness, ability and trustworthiness to pay on the past due balance, and future need for the product or service. Has the customer sought out a competitor of the vendor to replace it? Has the customer become untrustworthy, for example, by placing an unusually large order and in a hindsight learning the debtor did have the cash flow to pay?

Some ways in which the vendor can determine whether a customer may commit to a repayment agreement and has the financial wherewithal to repay the debt: request financial projections that support the customer can honor the repayment agreement and future sales. If the customer is a business organization that is privately held and takes the position that financial information is not shared, the vendor can offer a confidentiality agreement to overcome the resistance. If the customer still refuses to share the information, this may be a red flag that the customer cannot honor a repayment agreement.

The vendor may also gather facts about the customer's financial standing, including assessing future sales as part of the repayment agreement, through third party comment, including salesperson visits to the account, contacting the customer's bank, which was given as part of the credit application process

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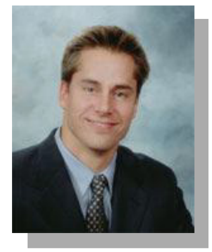
TIME FOR A CHANGE – THE ORDINARY COURSE OF BUSINESS DEFENSE IN CALIFORNIA ABCS



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In many states, including California, an option available to companies in financial trouble is an assignment for the benefit of creditors (ABC). An ABC is an alternative means of liquidating a financially troubled debtor, in lieu of a liquidation under Chapter 7 of the U.S. Bankruptcy Code. An ABC is defined as "a voluntary transfer by a debtor of its property to an assignee in trust for the purpose of applying the property or proceeds thereof to the payment of its debts and returning any surplus to the debtor." ABCs are, therefore, nothing more than a special type of trust which the assignee holds property for the benefit of another (the creditors of the assignor). The assignee owes fiduciary duties to the creditors in the same way a trustee owes fiduciary duties to the trust beneficiaries.

An ABC is governed by state law rather than federal bankruptcy law. However, defenses to a preference action in a California ABC are modeled after the preference laws in the United States Bankruptcy Code. Unfortunately for creditors, the recent revisions to the preference laws under the Bankruptcy Code have not been integrated into the California Code of Civil Procedure.

In California, the company and the assignee enter into a formal "Assignment Agreement." The company must also provide the assignee with a list of creditors, equityholders, and other interested parties (names, addresses, and claim amounts). The assignee is required to give notice to creditors of the assignment, setting a bar date for filing

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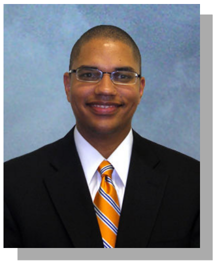
RECEIPT OF VENDORS' GOODS IS THE MEASURING STICK



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Congress, in an unmatched effort in recent times, reformed the United Stated Bankruptcy Code in 2005. Although a customer filing for bankruptcy can many times spell disaster for vendors, the reformed Bankruptcy Code does provide some areas of vendor leaning benefits. One of the most potent reforms in favor of vendors is the addition of section 503(b)(9). Section 503(b)(9) gives vendors an administrative priority claim in a bankruptcy case for "the value of goods received by the debtor within 20 days before the date of the commencement of a debtor's bankruptcy case." At first blush this smells of a reclamation right, and as will be discussed later it has been treated like a reclamation claim in some respects.

This provision of the bankruptcy code, if properly utilized by vendors, gives vendors a claim that is higher in priority for payment than most other general unsecured claims in the bankruptcy priority scheme. Further, unlike traditional reclamation claims, whereby the vendor must prove up their reclamation claim and follow strict timelines for giving notice to the debtor of that claim, section 503(b)(9) is satisfied by simply filing a motion for allowance of the claim at some point during the bankruptcy case before the confirmation of the plan, subject to any bar dates that are inclusive of 503(b)(9) claims. As will be discussed later, it is vitally important that vendors keep an eye out for motions related to 503(b)(9), especially those filed by the debtor. These so-called global procedures motions can set out the procedures that vendors must follow to properly assert their 503(b)(9) claims, and failure to timely adhere to the procedures contained in the motion, if approved by the court, can result in the loss of that claim, at least under 503(b)(9).

A topic of discussion that often rears its head in the dialogue of section 503(b)(9) is the meaning of the twenty day time period referred to in the provision. Does the twenty days begin to run from the time the creditor ships the goods to the debtor? What if the debtor gains constructive possession through a free on board provision in a contract that triggers at some point before the goods actually reach the debtor? There is good and bad news when it comes to questions surrounding the twenty day time period that is relevant when discussing section 503(b)(9). The bad news is that section 503(b)(9) is in its infancy. The section was added to the U.S. Bankruptcy Code less than four years ago, and many courts have simply not had the opportunity to wrestle with many of the questions related to the newly added section. The good news is that there have been a couple of key decisions from fairly persuasive courts addressing the treatment of the twenty day portion of 503(b)(9) and giving future courts a framework with which to work from.

The operative word in section 503(b)(9) is the word received. Section 503(b)(9) does not define received, but it seems clear that courts in the future will look to the traditional Uniform Commercial Code definition of received under state law reclamation rights. A bankruptcy court, in the recent case In re Pridgen, specifically held that the term received will be defined under section 503(b)(9) as it is defined under the reclamation laws of the UCC. 2008 WL 1836950 (Bkrtcy. E.D.N.C. 2008). Courts have increasingly found parallels between section 503(b)(9) and reclamation under the UCC, and the treatment of the term receipt by this court is a further example of that treatment.

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FROM THE PUBL I SHER :

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A CREDIT MANAGER'S JOURNEY FROM QUOTE TO CASH

Robert S. Shultz

You Have to Look at a Company Holistically

Management focus on a company's quote to cash processes can positively impact cash flow, operating expense and customer service. The hidden prize is the potential positive effect on revenue.

When a company is experiencing an increase and aging of Accounts Receivables balances it can be a result of several factors. Customers, who have historically paid at, or near terms, are now paying slowly. Customers may be taking an increasing volume of deductions. Disputes, short pays and deductions may be a signal that your internal processes or product quality needs to be examined and improved. As the economy becomes tighter customers may also be taking unearned deductions as a payment delaying tactic. The key is to understand what is really impacting collection performance and take action quickly.

When Accounts Receivable balances increase Senior Management's typical reaction is to assume credit and collection department is accountable. This is where management has to focus to get cash flow back on track. The first reaction is to review and tighten credit and collection policies. The Credit Department must do what is necessary to reduce risk of slow payment and potential bad debts.

Senior managers often look no farther than the collection process and supporting staff. However this area is only part of a much larger weave of connected processes that really drive performance. Management must set a broader scope to find and stamp out root cause issues affecting optimal performance.

It is critical to go upstream in the quote to cash process. There is a chain of interrelated steps that drive what ultimately becomes an open item on the Aged Trial Balance or causes processing delays, inefficiencies and reworks. This goes far beyond the walls of the credit and collections department. The focus must

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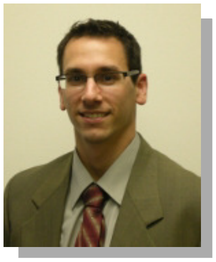
WHAT'S IN A NAME? MISIDENTIFYING THE DEBTOR ON FINANCING STATEMENTS UNDER REVISED ARTICLE 9



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Intro/PMSI

In today's economy, selling unsecured on open account may carry significant risk for vendors. However, taking a security interest in the merchandise sold may reduce or eliminate such risk. This type of security interest, called a purchase money security interest or "PMSI", is the most common and important secured transaction under article 9. To obtain a valid PMSI, the debtor must first execute a security agreement giving the vendor a security interest in described merchandise. Then, the vendor perfects the security interest by filing a financing statement with the fialing office (generally the Secretary of State). The vendor who takes the proper steps to perfect its PMSI is entitled to the cash proceeds from the sale of its merchandise.

Strong Arm Powers

Section 544(a)(1) of the Bankruptcy Code gives the trustee in bankruptcy the status of a judicial lien creditor. This status, known as the trustee's 'strong-arm power', gives the trustee the power to avoid any Article 9 security interest that would be subordinate to the rights of such a lien creditor. Accordingly, the trustee can avoid a security interest that has not yet been perfected as of the date the bankruptcy petition was filed. Since most security interests are perfected by filing a financing statement, the standards for measuring compliance with the filing requirements are critical when determining whether a security interest can be avoided.

Revised Article 9

In general, the changes introduced by Revised Article 9 make it more difficult for security interests to be avoided in bankruptcy. For example, Revised Article 9 reduces the types of errors that can render the recordation of a financing statement ineffective. Only errors in the debtor's name, secured party's name or indication of the collateral can render the financing statement ineffective. However, since financing statements are indexed by the debtor's name, the debtor's name is the essential element to locating the financing statement in the registry. Given the new standards that determine whether a financing statement sufficiently lists the name of the debtor, the degree of error necessary to render a financing statement ineffective due to it being "seriously misleading" may be less than what was previously allowed.

While Revised Article 9 provides clearer rules for determining the correct name to use for a debtor on a financing statement, it also removes human judgment from the determination of when the searching party has satisfied its burden. It has shifted the burden from the searching party, who used to be required to search under alternative permutations of the debtor's name, to the filing party, who is now required to ensure the security interest will be found when a searcher uses the correct name.

Under the old Article 9, as long as a financing statement substantially conformed to the requirements of the statute, minor errors were not misleading. Instead, courts created and relied upon a "reasonably diligent searcher" standard, which allowed the reviewing court to determine whether a hypothetical reasonable search would have resulted in the discovery of the non-conforming financing statement despite the error in a debtor's name. This "reasonably diligent searcher" standard allowed courts to determine what searchers should or should not have discovered in their search.

Under Revised Article 9, the reasonably diligent searcher standard is replaced with a bright line standard based on the computerized search logic of the filing office. Here, if a particular security interest cannot be located using the state's standard search logic, the filing is deemed 'seriously misleading'. In other words, a financing statement is effective if the computer search run under the debtor's correct name produces the financing statement with the debtor's incorrect name. If the financing statement with the debtor's incorrect name is not produced, then the financing statement is ineffective as a matter of law. Thus, while providing a clearer bright-line type rule, the Revised Article 9 removes the burdens placed on searchers as they no longer have to perform multiple searches using countless variations of the debtor's name.

Search Logic

Unfortunately, there is no standard search logic. It is still evolving and some states may

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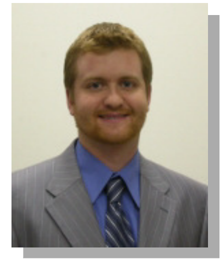
VENDORS AND SUPPLIERS OF THE BIG THREE: BAILOUT, CHAPTER 11, REORGANIZATION, OR BUST?



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The titans of the American automobile industry, the Big Three: General Motors ("GM"), Ford, and Chrysler, are potentially the next victims of the economic downturn of 2008. Vendors and suppliers to the Big Three need to be aware of the potential impacts to their businesses as the Detroit companies attempt to reorganize amidst the economic storm.

A "prepackaged bankruptcy" may be what one or all of the Big Three is headed for. A prepackaged bankruptcy is a plan for financial reorganization that a company prepares in cooperation with its creditors that will take effect once the company enters bankruptcy. This plan must be voted on by shareholders before the company files its petition for bankruptcy, and can result in less time in bankruptcy.

Once a model of innovation and efficiency, the Big Three have seen losses of market share and plummeting sales, placing all three, especially GM, at the precipice of a liquidity crisis. There has been heated debate about how, or if, government should be involved in a restructuring of U.S. automakers, and whether a bailout or bankruptcy will allow these companies to regain profitability.

Absent political positions, there is a general consensus that business as usual is not an option. Estimates have GM burning through more than $2 billion each month with only $16 billion left in reserve. Simple math shows that if GM continues on its current course it will not live to see New Year's Day 2010, and many analysts see Ford as not far behind.

The debate rages on in Washington. On one side, hard-lining capitalists believe the market should decide the fate of the U.S. automakers, and would favor bankruptcy over bailout. The other side, arguing public policy, see a failure of one of the Big Three as

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GETTING YOUR LENDER'S SUPPORT IN THESE FINANCIALLY UNCERTAIN TIMES: THE DO'S AND DON'T'S WHEN RENEWING OR OBTAINING A LINE OF CREDIT

Al Chavez &
Scott Blakeley

In the beginning of 2006 plummeting home prices, continued subprime delinquencies, and tight credit markets have resulted in a number of bankruptcy and out-of-court workouts for homebuilders and developers. Homebuilders and developers are experiencing an industry wide slowdown including not only a decrease in demand for new homes, but also an excess of existing homes. Inventory of homes is at a 23 year high, with 4.55 million houses available. Some experts have said that this is the worst economic situation the industry has found itself in since the Depression.

Record numbers of homebuilders and developers are filing bankruptcy across the Untied States including DenMark Construction Inc., Kimball Hill Inc., Randall Martin Home Higley Park LLC, PFP Holdings, Copper Hill Estates LLC, R&B Construction Inc., Tousa Inc., and Whitlatch & Co. Due in part to declining land and home values, the nation's most significant home builders have found themselves with more than $24 billion in impairment charges, according to Standard & Poor.

Earlier this year there was an unexpected drop among confidence in homebuilders, giving evidence to the experts who forecast the downturn may extend for a period. The National Association of Home Builders/Wells Fargo index of builder sentiment hit an all time low of 16 this summer.

As a subcontractor that looks to some bank financing to meet your operating expenses, keeping on good terms with your lender can be key for smooth operations in these financially difficult times. In today's environment it has become increasingly more difficult to obtain additional or new financing. Here are some do's and don'ts to consider in this economy.

Do's

Communicate with your lender on a regular basis. This means to be upfront with your lender when you anticipate problems, even though they may not materialize. The last thing a lender wants to hear or discover is that you have problems that could have been solved much earlier. These could be problems in collections, a potential concentration of receivables with one or more customers which could lead to loss of loan availability, or a loss of a significant customer or project. So, for example, confirm that you are in compliance with the respective state lien laws. Lenders want to be your partner and they can help if you are having cash flow problems, for instance. If a significant customer notifies you that they are in a dispute with their construction lender, you should advise your lender. It is more difficult for the lender to react after the event occurs.

If you have a business plan, update it as events change, and share it with your lender whether it is good or bad news. If a customer files bankruptcy, or a particular segment of your industry is struggling, advise your lender. If you don't have a business plan, consider spending the time to write one or hire a consultant to assist you. The same holds true for your operating budget, which should be in detail.

The plan should include a short history of your company, a current list of management with their duties and responsibilities and prior background, historical and forecasted financial statements, forecast of availability on the line of credit, geographic areas you service and your competitors in each area, and a list of significant customers and a list of projects for each customer and the status of each project such as 20% complete or 50% complete.

Be prepared to discuss each customer and project with your lender. They will want to know what procedures you used to qualify the customer or project. What financial information you have that assisted you in this decision and if you have current financial information. Do you know your customer's construction lender? What is the high credit? Has the customer honored progress payments to suppliers and material men? How long have you been doing business with the customer? What are the prospects of future projects? Do you consistently enforce your lien rights, or take personal guarantees from your customer? Have you ever received NSF checks from the customer? They may ask for copies of the contracts and subcontracts with your customers.

Review your credit and collection policies and confirm they are being followed. Require that you receive financial updates

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COMMERCIAL CREDIT AND THE RECESSION (cont.)

as part of the repayment agreement, talk to industry group members, other vendors and the landlord about their past experience with the customer. The Internet can also serve as a search tool to determine the availability and sufficiency of security should the vendor insist that the repayment agreement be secured, as well as an asset and UCC search, including real estate search.

The vendor should also confirm whether other creditors, including the debtor's landlord have initiated collection actions against the debtor. Many state and federal courts now have electronic dockets that the vendor can confirm whether lawsuits have been filed in the debtor's home venue. The importance of learning whether other creditors are being paid and, if not, what steps they are taking if not, is tied to whether the vendor has the luxury to work with the debtor to have the delinquent account paid over time. In some settings, certain creditors may be rushing to the court house to force payment on their delinquent accounts which forces the vendor to reassess the repayment agreement strategy.

With the framework of alternatives to a repayment agreement, the vendor must also consider the debtor's insolvency or bankruptcy risk. If the debtor files bankruptcy the automatic stay arises, which bars the vendor from collecting on the unsecured past due balance, including beginning or continuing lawsuits, collection calls, repossession, foreclosures, garnishments or levies.

The automatic stay remains in effect until the bankruptcy judge lifts the stay at the request of a creditor, the debtor obtains a discharge, and/or the item of property no longer remains part of the debtor's bankruptcy estate.

The vendor must also consider the impact of a bankruptcy preference with strategies to collect on the delinquent account. A preference is a payment made by the debtor to a creditor within a defined period of time, prior to the debtor's bankruptcy filing. Because a preference gives the creditor who received the payment an advantage over other creditors in the bankruptcy case, the trustee can recover the preference (the amount of the payment) and distribute it among all of the creditors.

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COMMERCIAL CREDIT AND THE RECESSION (cont.)

B. The Repayment Agreement in Action

Repayment agreements are a product of negotiation. The vendor seeks to include as many terms that create the leverage that the debtor will focus on honoring the repayment agreement. Some of the terms for the vendor to consider in a repayment agreement are:

Fixing the Indebtedness

In active trade relationship, where the vendor offers trade concessions to make sales and where the customer may take deductions, unauthorized and otherwise, the amount owing the vendor may be disputed. The debtor may also dispute the debt through claims such as defective product or late deliveries. Should the vendor sue to collect the delinquent account, the vendor may be surprised to find it the target of a counterclaim—a lawsuit filed by the customer. Given the uncertainty of the amount of the debt with some customers, a vendor may use the repayment agreement as a way to eliminate this kind of risk.

A repayment agreement should fix the amount owed, including fixing the amount of customer concessions and disputes. By fixing the amount owed, the vendor eliminates later disputes that may arise as to application of payments and concessions. Fixing the indebtedness can be helpful should the debtor fail to honor the terms of the repayment agreement and the vendor seeks to enforce the debt.

Fixing Repayment Schedule

The repayment agreement should provide a fixed schedule for repayment of the debt. The repayment schedule may be on a monthly basis. The benefit of a fixed schedule allows the vendor a clear timetable for repayment of the delinquent account rather than a mere understanding that the debtor will pay the amount owing when the debtor has free cash. This can be important where a debtor files bankruptcy and the vendor received payment within the 90 days prior to the bankruptcy filing

Discounting the Face Amount of Invoices

A repayment agreement requires the debtor's consent, and therefore may result in heated negotiations. Such issues as the term of the repayment agreement, the balance owing, additional credit sales, security, a guaranty, balanced with collection alternatives are considered by the vendor.

There may be instances where a vendor agrees to discount the face amount of the past due invoices to reach a compromise, say 10% or 15%. The repayment agreement may provide that in the event of a default by the debtor, the face value of the past due invoices become due and payable—the debtor loses the discount. An exception may be where the debtor defaults on the repayment agreement near its end. Should the vendor seek to enforce the face value of the invoices, a court may find such provision unenforceable.

Waiver of Counter Claims and Disputes

The repayment agreement protects the vendor from challenges later brought by the customer that an amount owing is in dispute, that the product or service provided is defective, or that the documentation supporting the debt is incorrect. By waiving all defenses, the debtor allows the vendor to promptly proceed to judgment should the debtor default on the repayment agreement.

Taking Collateral

Another method to have your customer focus on honoring the repayment agreement is to insist on collateral to back up the repayment agreement. This can take the form of the debtor granting a junior security interest in all of the its assets. Whether the debtor will grant such an interest will depend on the debtor's existing lender's consent, as well as the debtor's perception of other vendors' reaction to granting a security interest.

Clean Up Documents

With the vendor's initial credit evaluation, there may be times where a customer refuses to sign a credit application, or in the rush for an initial sale a credit application is never taken. In these settings, the vendor may find its documentation is not in order. Perhaps a mislabeled invoices of who the customer is, or the kind of business organization the vendor has sold to. Should a dispute with the debtor arise, or invoices otherwise go unpaid, the vendor may find needless defenses raised by the debtor as to the documentation, which may slow payment on the account.

A repayment agreement may also help the vendor from the surprise of finding new owners of the debtor. Without the repayment agreement, the debtor's new owners may dispute their liability with the existing documentation. Depending on the duration of the repayment agreement, the vendor may include a notice requirement that the owners must notify the vendor in writing of any change in ownership, the name or the business structure under which the credit is established.

In addition, vendors that as part of the initial account evaluation that have taken collateral, such as a purchase money security interest or junior security interest in the debtor's assets, or have a consignment agreement, must comply with Article 9 of the Uniform Commercial Code. Should the vendor have failed to have properly complied, the vendor may find its security interest or consignment agreement subject to challenge. A repayment agreement can also be used to clean up what otherwise may be improperly perfected security interests or consignment agreements.

Guarantees

To back up the repayment agreement, the vendor may insist that the debtor's principal of a closely held corporation or limited liability corporation 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. If the debtor is part of a family of companies, the vendor may seek a cross corporate guarantee.

Preference Defense

Although the customer may enter into the repayment agreement and honor the payment terms of the repayment agreement with the vendor or class of vendors, the debtor may still be forced into bankruptcy. A vendor does not want to negotiate a repayment agreement and forebear on more immediate collection alternatives, only to find some or all of those payments clawed back by a trustee. A vendor that chooses the litigation alternative to collect on the past due invoices has a preference risk if the vendor levies on a debtor's accounts or records a lien against the debtor's property within 90 days of the preference filing. Thus, a question for the vendor is whether payments received under the repayment agreement during the 90 days prior to the bankruptcy filing a preference?

The vendor's defense to a preference demand is that the repayment agreement has replaced the delinquent invoices. Therefore, if the debtor paid according to the terms of the repayment agreement, the vendor may contend that such payment was made in the ordinary

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COMMERCIAL CREDIT AND THE RECESSION (cont.)

course of business under section 547(c) of the Bankruptcy Code and conformed with the repayment agreement, not past due invoices.

Favored Vendor Clause

If the vendor commits to take payment on the delinquent account over time, and perhaps discounts its invoices, the vendor does not want a surprise that the debtor has entered repayment agreements with other creditors with comparable balances o that treat the vendor less favorably. Therefore, the repayment agreement should provide that if the debtor favors a creditor that constitute a default.

Fees and Costs

The repayment agreement should include an attorney's fees provision, as well as late fees and default interest should the vendor be required to enforce the defaulted repayment agreement.

Venue

If the debtor is out-of-state, or out-of-country, the repayment agreement should provide that venue favors the vendor in the event of enforcing the defaulted repayment agreement.

Default

The vendor's patience of agreeing to take payment over time should not be rewarded with the debtor repeatedly paying late under the repayment schedule. To that end, to encourage the debtor to honor the repayment schedule, say payment is due the first of each month for the next six months, the debtor is faces a finance charge or late fee for the first late payment. However, if the debtor pays late a second time that may result in a default that is not curable and the vendor can obtain a judgment for the balance owing.

Acceleration Clause

Should the debtor fail to pay, the repayment agreement should provide that the entire balance owing under the repayment agreement is due.

Stipulated Judgment

A stipulated judgment is a judgment where the debtor and vendor have agreed to a judgment in the event of the debtor's default. If the repayment agreement is not followed, the vendor can file an affidavit of default where the judgment can be entered. Enforcement of the judgmet can take many forms, but can include property liens and levies.

Confession of Judgment

A confession of judgment provides that the debtor admits liability and agrees on the amount of debt that must be paid to the vendor. A confession of judgment may be filed as a court judgment against the debtor who does not honor the repayment agreement. The confession of judgment provision attempts to minimize the need to resort to legal proceedings to resolve the delinquent account. The enforcement of a confession of judgment depends on state law. Some states may not allow, while others give protections to the debtor by requiring that the must obtain consent from the debtor's counsel to be enforceable.

Continued Credit Terms

In a recession, revenues continue to be essential for the vendor, especially as sales orders from financially sound customers are harder to come by. Likewise, for the debtor that is struggling to keep its supply sources providing terms, the debtor will often insist that the repayment agreement provide the vendor commit to terms for the duration of the repayment agreement. This is a call for credit, sales and management. Of course, the credit professional will need to provide a written opinion of the credit risk of future sales, compounded with the debtor repaying on the past due balance. This puts the credit professional in the role of customer relationship builder.

Credit Policy and SOX Compliance

In a recession, the best practices for a credit department is to document past due invoices that will be paid over time with a repayment agreement. Those vendors that are publicly traded and SOX compliant may have their auditors insist on repayment agreements as part of their internal controls and procedures. The repayment agreement may provide a more accurate recording of the collectability of the past due balance, and therefore financial reporting.

C. Repayment Agreement Alternativeves

A repayment agreement requires the debtor's consent. If the debtor refuses to agree to a repayment agreement, the litigation alternative needs to be considered. A vendor may file suit for breach of contract, coupled with a prejudgment remedy such as a writ of attachment. This collection action my force the debtor into a repayment agreement in hopes of avoiding the suit. If the debtor does consent in this setting, the vendor should add the collection costs and interest to the past due balance.

If the vendor has an arbitration provision in its credit application or supply contract, the vendor may invoke this where the debtor refuses to the repayment agreement to deal with the past due invoices. As with collection suit alternative, the debtor may respond to the arbitration demand by consenting to the repayment agreement. The collection costs should be added to the past due balance.

D. Repayment Agreements in a Recession

Many long standing customers that have been a significant source of business for vendors may find themselves in financial difficulty as a result of the downturn in the economy. These are customers that have a good faith intention of working out their short term financial difficulties. In these settings, a vendor may be better served to work with the customer, but have a more formal commitment as to dealing with the dealing the delinquent account, such as a repayment agreement.

TIME FOR A CHANGE (cont.)

claims with the assignee that is between five to six months later. Given the added administrative costs of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) and the resulting narrowing of the benefits of bankruptcy to corporate debtors, many practitioners believe that California will see a resurgence in the use of non-bankruptcy alternatives to satisfying the obligations of the financially distressed, including the of ABCs.

Preference laws in California ABCs has been wildly unsettled. Serious doubt was cast on the ability of an assignee for the benefit of creditors to use underlying state law to prosecute avoidance actions by the Ninth Circuit Court of Appeals' decision in Sherwood Partners v. Lycos Inc. In Sherwood Partners v. Lycos Inc., the Court of Appeals found that state preference laws were preempted by the Bankruptcy Code, and that assignees could not pursue preferences in the district courts of the Ninth Circuit. In the decision's immediate aftermath, many wondered aloud whether assignments and other nonbankruptcy proceedings were in

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TIME FOR A CHANGE (cont.)

jeopardy. However, thereafter, the California Supreme Court upheld the validity of California ABCs and an assignee's right to pursue preferences in state court. Accordingly, whether an assignee for the benefit of creditors can pursue preference actions under California state law depends upon whether the preference action in question is before a state court or a federal court.

Many courts and commentators agree that under BAPCPA, which is applicable to bankruptcy cases filed on and after October 17, 2005, it is easier for trade creditors to satisfy the ordinary course of business defense to preference claims. In BAPCPA cases, the creditor must prove the transfer paid indebtedness incurred in the ordinary course of business of the debtor and creditor, and the transfer was made either: (1) in the ordinary course of business of the debtor and creditor - a subjective test, or (2) according to ordinary business terms - an objective test. This is in contrast to the ordinary course of business defense applicable to pre-BAPCPA bankruptcy cases where the creditor must satisfy both the subjective and objective tests.

In making the subjective and objective tests disjunctive, the U.S. Congress sought to make the ordinary course of business defense easier for creditors to establish. One Delaware court stated specifically that under the BAPCPA "Congress intended to make it easier for transferees to protect ordinary course payments."

Unfortunately, the 2008 California Code of Civil Procedure Section 1800(2) states "To the extent that the transfer was all of the following: (A) In payment of a debt incurred in the ordinary course of business or financial affairs of the assignor and the transferee. (B) Made in the ordinary course of business or financial affairs of the assignor and the transferee. (C) Made according to ordinary business terms." As shown, both the subjective and objective tests must be proven.

With the gap in the ordinary course of business defense between under BAPCPA and the California Code of Civil Procedure Section 1800, the momentum is back in favor of the assignee and against the creditor. Unless the creditor can substantiate a basis for removing the state court action to federal court (based on diversity of citizenship), the creditor will carry the heavy burden of satisfying both the subjective and objective tests under the ordinary course of business defense.

RECEIPT OF VENDORS' GOODS IS THE MEASURING STICK (cont.)

Under the UCC, receipt is defined as the taking of physical possession. This is simple enough. The debtor must actually have the goods in hand under the UCC's definition of the term receipt. Therefore, when one speaks of the twenty day timeframe under section 503(b)(9), that time frame under the previously cited case begins to run the moment the debtor takes physical, not constructive, possession of the goods.

It is therefore clear that constructive possession is of no consequence with regards to the twenty day time frame under 503(b)(9). Merely delivering goods to a common carrier where there is an f.o.b. provision delivering constructive possession to the debtor the moment the goods reach the common carrier will not affect the analysis above. Courts have been fairly clear that free on board is a contract term used to determine which party to a contract bears the risk of loss while the goods are transported from the seller to the purchaser. Free on board provisions do not have the same use when analyzing a reclamation issue, or conducting a 503(b)(9) analysis. Again, 503(b)(9) does not turn on the passage of title. The focus of the Bankruptcy Code is on receipt of goods, and not the delivery of those goods.

Ergo, it is clear that vendors will want to look at the date in which the debtor took physical possession of the goods when analyzing their 503(b)(9) claim. This can play to the vendor's advantage in situations where delivery to a debtor is a slower process due to the size or form of transportation. Those vendors could see deliveries that would fall into the 45 day piece of the reclamation claim heralded to the ranks of an administrative claim under 503(b)(9). Further, even though we do not have the same time constrictions for notice of the 503(b)(9) claim as we do with traditional reclamation claims, it is important to look for bar dates specific to 503(b)(9) claims. It is common for debtors to file global procedures motions relating to 503(b)(9) claims whereby proofs of claim or motions for allowance must be filed by stated timelines. However, if properly asserted, the 503(b)(9) claim can prove to be a potent weapon in a vendor's arsenal for collection when its customer files for bankruptcy.

A CREDIT MANAGER'S JOURNEY FROM QUOTE TO CASH (cont.)

involve all areas of the business. Pricing and terms policies, credit policies, product quality, administration of product delivery and returns, order management, billing, the collection and dispute management process and infrastructure, cash management processes and cash application all impact a company's ability to manage incoming cash flow.

So Where Do I Start?

By taking a "holistic" approach Managers can integrate the entire "revenue chain". The first step is to establish a cross-functional team to a review root cause issues and the impact of:

- Interrelated processes
- Organizational structure and hand-offs
- Systems and automation tools

Following are ideas to effectively approach this issue by coordinating all process stakeholders in the company. Actions can be taken to positively impact collection performance, operating efficiency, customer service and revenue growth at each step of the quote to cash process.

So What is the "Quote to Cash Process"

Pricing and Terms of Sale:

It all starts with how deals are made between the company and its' customers. Deals that involve extended terms or complex pricing, discount, or rebate policies may be difficult to administer. Often special arrangements are not communicated to areas that have to deliver what has been promised. If a company's systems and processes are weak the result can be inefficient, manual and error prone workarounds.

Pricing and terms and credit policies must work in concert. There is an inherent friction between the Sales and Finance side of the business. Sales people are perceived as self-serving and likely to give the store away if there is a commission involved. Finance is seen as a gate keeper, or the "Sales Prevention Squad". The reality is that both areas need one another for the company to thrive.

Terms and pricing are sales tools but…. In tough times, Sales and Marketing use payment terms and aggressive pricing as a tool to gain market share. It is imperative that the

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A CREDIT MANAGER'S JOURNEY FROM QUOTE TO CASH (cont.)

credit function works within this framework. Effective credit policies and administration should be used as part of the effort to increase company revenues.

But… it is a two way street. The company's cash flow requirements, administrative capacity and costs must be part of the equation. Coordination and a high level of communication between Sales, Finance and Credit and Collections are essential.

The fact is that pricing complexity breeds administrative problems. Complex or dynamic pricing policies can create a sales administration nightmare. It is critical for Sales Administration and Credit and Collections to play a part in how these policies are formulated.

Competitive deals are essential to keep or gain market share. However, if for example, systems to manage and track complex transactions are not there, the result is manual effort and misunderstanding. This negatively impacts internal operations and even worse, customer facing processes and relations between the company and its' customers.

As pricing and terms policies are being developed all parties responsible for dealing with the aftermath need to participate. It is to Sales advantage to know where the issues and concerns are upfront. Other areas need to be flexible and creative. If there are concerns about a deal it is essential these be raised up front so that a solution can be developed that meets the needs of the business and can be dealt with effectively and efficiently by all internal stakeholders.

Credit Approval and Review: "A slave to two masters" which one is it?

Any company granting trade credit is a slave to two masters. One is slow payment increasing the cost of funds and lost working capital opportunity and the other is the risk of non-payment by debtors.

Decide based on facts. Extended terms have both a cost and a risk. This should be quantified as deals are being developed. The result will be knowledge based business decisions that consider both the competitive marketplace and the real financial consequences.

Establish an effective Credit Policy. The first critical step is to implement an integrated credit policy signed off by senior management. This will encourage consistent adherence and effectiveness. The policy must address both the company's need to generate revenue and the level of risk necessary to remain competitive and meet financial objectives. It cannot be developed in a vacuum. Stakeholders from all functions should participate in the creation and buy off on the end result.

All Stakeholders should collaborate up front. As credit decisions are made the credit manager must be involved from the start. It is to sales' advantage to include the credit manager as new channels or customer relationships are being contemplated. A preliminary credit review of sales prospects can help sales understand the customer's potential and if special credit arrangements may be required. Good communication between Sales, Marketing and Credit will set the stage by ensuring all involved thoroughly understand the company's objectives and strategies. The needs of all areas will be considered.

There will always be exceptions. Any credit policy should include easily understood and quick turnaround escalation policies. This will enable timely "business decisions" when an exception to policy is needed. Define and delegate signature authority for business decisions beyond formal policy limits. As the materiality of the decision increases the authority escalates to the next level. Sales and Finance should both be required to agree. Ultimately a final decision may have to be made at the most senior level.

Obtain a complete Credit Application. Complete information on the customer is critical if there is a collection issue. The information on the credit application becomes a valuable resource to contact the company's principal or a senior executive, bank contacts or other trade partners originally listed as trade references. It can also incorporate terms and conditions an applicant has agreed to up front assisting collection issues downstream.

No surprises on special credit requirements. It is much better for everyone, including the customer, to know about special requirements up-front. Why waste precious sales time on accounts with low potential. If cash terms or some form of security will be required, it is better to communicate this before the sale is in the forecast.

"We never say no… Yes but how?" With this approach in place credit becomes a partner not an obstacle or some obscure accounting function with little connection to what is really going on in the business. By being solutions oriented the aim is to motivate sales to seek information from the credit department. Credit will become a marketable product that enhances sales opportunity and bottom line profit.

Utilize Credit Modeling/Scoring tools: There are excellent software tools in the marketplace to customize credit policies and automate the analysis and escalations. This will speed up the decision process and shorten the time to turn an opportunity into revenue.

The credit manager can incorporate and weight factual data such as financial information, historical payment experience and database ratings. Subjective criteria can be considered such as the profitability of the sale, potential impact in market share, input from Sales on competitive issues and the analyst's opinion.

By imbedding the company's credit policy into the scoring model sales and customers are assured that credit decisions will be "Consistent, Predictable and Fair".

Credit reviews are essential. Continued credit worthiness must be reviewed on an ongoing basis, both at the customer and portfolio level. This will help to direct sales towards high potential channels and customers. By identifying areas with a high risk of delayed payment or bad debt Sales can redirect wasted effort towards higher opportunity prospects. A credit review should take place:

- Periodically based on the dynamics of the market. (quarterly, bi-annually, but at a minimum annually)
- If there is a significant increase in sales volume
- If the payment pattern shows deterioration
- If negative financial results are reported
- Poor trade ratings from industry trade interchange groups or rating services
- Change in senior management or ownership
- There are a high number of trade reference requests

An effective credit hold is no secret. The credit-hold process should be well communicated within the organization. The extent to which customers are given advance notice and the degree to which salespeople are used for collection, varies between industries.

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A CREDIT MANAGER'S JOURNEY FROM QUOTE TO CASH (cont.)

It is critical however for sales to know a credit hold is being imposed. This should be communicated as far in advance as the situation allows.

At the end of the day a credit hold is a collection tool and can reduce bad debt exposure. For maximum effect, when a credit hold is imposed, pending shipments are held and order taking is stopped. Many companies handle this manually. Companies with multiple business units often times deal with the same customer across business lines. It is imperative for each area to know what the others are doing and act in coordination. Administering this process effectively is critical to both motivate slow payers to pay current and to reduce the risk of non-payment. To the extent that the credit hold process can be incorporated into system based controls it should be.

Order Management: Accuracy, visibility and timeliness are key

Order management must be accurate and integrate with company pricing, terms and credit policies. This is where administrative discrepancies begin. Poor order management practices have an increasing downstream impact as companies migrate to electronic forms of order, invoicing and payment. As transaction volumes increase, problems reach a new level of complexity and financial impact.

Create and maintain a thorough and accurate customer master. In order for billing activity to flow smoothly through the customer's accounts payable process, it is critical that all information on the invoice be accurate. This starts with an accurate customer master at your end. If customer contact information or bill to and ship to detail are inaccurate errors and delays will result.

Consolidate control over customer master creation and maintenance. A consistent and harmonized customer master is especially critical for companies with multiple business units having common customers. By having consistent customer tracking including family tree transparency you can track total exposure, payment and deduction trends.

Do it right the first time. Process and system safeguards need to be in place to reduce the opportunity for error. If errors occur there needs to be timely visibility so corrections can be made. Aside from the internal impact and cash flow consequences, this is critical to customer care. Everyone in the organization must work together to do it right the first time.

Billing… "It's in the format and timing"

Customer billing today is accomplished with paper invoices and increasingly by electronic means. As billing is converted to an electronic format it is essential for both parties in the transaction to do thorough up-front work. This will insure both the buyer and seller's system communicate accurately.

For those transactions billed by a traditional hardcopy invoice there are pitfalls that can delay payment.

These may seem simple however cash flow can be significantly improved by looking at these basic process components:

- Eliminate delays in mailing the invoice. Depending on how the customer's accounts payable policy and system are set up the date of receipt of invoice may have a lot to do with when payment is made. Timely mailing is particularly important in industries with short terms of sale.
- Clearly state the terms of sale or due date on the invoice.
- As simple as it sounds, make sure the invoice is sent to right location.
- Clearly state the "remit to" address.
- Avoid payments coming directly to the office. Do not include the company address on the invoice. A contact phone number/email address will suffice. Checks sent to a bank lockbox are deposited faster. Checks going to offices get lost or worse, they can be intercepted and fraud becomes an issue.

Question the need for statements: Companies pay invoices. Statements may clutter the desk in accounts payable and take away valuable processing time.

Consider a "Summary Invoice". If there is a high volume of invoice activity consider providing the customer a summary invoice. With proper backup this can reduce the time required for accounts payable to process payments.

Act on root causes for errors and delays. Determine root causes if there are repetitive errors in pricing, product description, quantity, ship to location etc. Quantify the issue and report the problem quickly to all appropriate areas in the organization. Put a meeting together if necessary to brainstorm corrective action and fix the issue.

Migrate to electronic bill presentment and payment. This saves processing time and increases staff productivity. Technologies are available that eliminate mail delay and automate the billing payment relationship. The Internet has opened electronic interchange as a practical solution to companies of any size.

Customer Service…. "Prioritize "customer facing" processes and events"

The customer relationship is a critical component of cash flow and risk management. People not technology, ultimately handle exceptions, respond to questions and go the extra mile when asked. Pay attention to customer needs. Any process step, document or personal contact directly between the company and the customer must be continually reviewed and adjusted to address customer requirements. This takes good communication with the customer and internally between all areas servicing "customer facing" processes.

Organize sales, customer service, collection, dispute reconciliation and cash application teams with common customer assignments.

"Centralize or decentralize that is the question" large companies with complex organizations with multiple business units and locations face continuous questions regarding what functions can be centralized for efficiency, performance and control. Companies choose between remaining localized and decentralized or to either outsource or create an internal shared service capability. There are advantages and disadvantages to each option.

The key is to create a team approach that is managed in a consistent way that addresses issues from all critical viewpoints. This can be accomplished by creating a customer centric or channel of sale centric organization.

Assign people in each functional area as specialists for specific customers, types of customers or customers within particular regions. Align work assignments so that all steps of the quote to cash process for a customer are handled by a consistent cross-functional team. This is possible leveraging the transparency of today's information tools, instant communication and remote access to real time data. Emphasize cross-functional communication and problem solving and

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A CREDIT MANAGER'S JOURNEY FROM QUOTE TO CASH (cont.)

accountability. The aim is to provide one face to the customer no matter the issue.

Cash Management and Application

Utilize lockbox arrangements and keep up with customer remittance policies. In spite of technology advances a high percentage of payments are still made by check. The best defense against today's sophisticated disbursement tactics are strategically located lockboxes. Mail float delay is a factor in cash flow for both buyer and seller. By understanding where payments are coming from, the creditor can establish banking arrangements to minimize mail float and get checks on deposit faster.

Take advantage of banking technology. Major Lockbox banks provide scanning and same day online viewing of remittance advice. This allows for payments to be deposited as delivered and provides cash appliers and collectors the ability to review remittances in advance of hard copy documentation. Scanned or electronically imaged remittance detail can also be archived for future research.

Take advantage of autocash. Autocash arrangements facilitate application of customer remittance detail directly to the accounts receivable system. If there is a high degree in item matching this can drastically reduce the need for cash applications headcount and speed up the process.

Consider strategic outsourcing. There are excellent service providers among the lock box banks. In some industries credit card sales can provide third party resource, particularly on low dollar, non-strategic business.

Take advantage of data on remittance detail. The customer identifies process and product issues each time a deduction is taken. Tie this valuable information into your process improvement efforts. By understanding root causes as early in the process as possible. Data gathered will also provide agenda topics for cross-functional process improvement teams.

Collections and Dispute Resolution… "Collections is not an accounting function"

Many companies mistakenly consider collections just another accounting function. They do not understand the fundamental differences. Properly run, collections is part of the basic business process of the company. It impacts customer relationships, revenue opportunity and identification of risks.

Effective collection requires actionable information. The collector and manager must have easy access to up to date information on each customer such as, the outstanding balance, aging, associated risk, payment history, promises made, open disputes and notes of recent contacts.

An effective collections process is proactive and focused. Tools must be available to both collectors and management to prioritize contacts. The workday should be structured to maximize customer contact and follow-up. Good account coverage is needed, however, collectors should not spend valuable time contacting volunteer payers or performing unnecessary clerical tasks.

Understand disputes, deductions and short payments. Disputes and deductions can be leveraged as a window into every step of the quote to cash process chain. Customer disputes may also reflect customer tactics to delay or avoid payment. In some cases this could be a valuable danger signal the customer is in trouble and is using your company as a bank.

The key is to quantify disputes by type and source. How many are earned vs. illegitimate. What is the root cause? Is it an internal training issue? Is there a process or systems breakdown? Is there a more efficient way to handle the process that is broken? It may be time to gather stakeholders from all areas touching the problem sequester them in a room and come up with a solution.

The problem may be with the customer….If the customer is abusing their terms through unearned deductions or short payments it may be intentional (a payment delaying tactic) or it may be indicative of process breakdowns at their end. Regular meetings should be set up with major accounts to ensure these issues are addressed and resolved.

Utilize automated collection tools: Major ERP solutions provide some level of collection and deduction management capabilities. Although there have been major strides made in the collections, deduction capability of these systems there may be specific advantages to supplementing them with a scalable "bolt on" solution.

There are several packages available in the marketplace with a wide-range of focused functionality. These solutions integrate with and leverage the company's investment in their current ERP. They are able to integrate with any system. Many companies use these products on multiple ERP's in multiple locations domestically and globally in a decentralized, share service or outsourced scenario.

Open book… These software tools provide access to anyone in the organization with a need to know. The Internet opens information to field or home offices and also enables customers to access their own activity, status and to obtain copies of invoices and other documents. Providing self-help tools within the company and to customers improves productivity and saves time.

Functionality to look for includes:

- Ability to assign groups of accounts to a collector or reconciliation analyst.
- Ability to define optimal collection strategies based on a customer's level of risk and payment habits.
- Daily prompting of collection contacts applying strategies to open balances.
- Allow user to enter contact notes with automated tools to reduce keystrokes.
- Automatic prompting for follow-up on promises.
- Provide the option to contact by phone, or customizable fax, email or letter.
- If the need is there, provide auto-dial capability.
- Provide problem resolution work- flow tools that allow user to assign problem reason codes and identify the responsible resolver in the organization.
- Track historical information such as customer payment history, disputes by type, status and timeframe from identification to resolution.
- Ability for authorized individuals in the company or the customer to access account. information and obtain copies of documents such as invoices, credit memos, statements etc.
- Robust management reporting tools and flexible dashboards.

Eliminate Paper based research. There are services in the marketplace that can archive documents and provide authorized users with Internet access. Using indexing techniques, data elements can be rearranged to provide ad-hoc reports for use in customer dispute research or even for sales and marketing purposes. These services can accept hardcopy documents for scanning, CD's or tapes or electronic file transfers. Use

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A CREDIT MANAGER'S JOURNEY FROM QUOTE TO CASH (cont.)

of this technology can save significant time in research and resolving disputes providing additional time for collection staff to focus on cash generating tasks.

Visit customers regularly: A good relationship with the customer can be the distinguishing factor between creditors who get paid on time and those who do not. It is important for a variety of reasons to conduct on-site visits. You are no longer just a voice on the phone. By being at the customer's location, you get a first hand look at the level of activity and get to meet the staff and review customer processes. You learn something on every visit.

If resources allow, the credit collections manager should consider also bringing the collector or the deduction specialist. Additionally, a team effort, including sales, customer service, operations and information technology, may be the best way to resolve process or systems issues involving both parties. This of course depends on the size and complexity of the relationship and the perceived payback.

Meet with Sales regularly: Sales provides a set of ears and eyes in the field for the collection organization. The Credit Manager and team should participate in Sales Team meetings. This provides an opportunity to seek sales input on collections issues and help Sales understand how important it is to report changes in customer condition or other cash flow related issues. This opens the door to trust and regular communication between the groups.

If you can't measure and report it how can you manage it? Establish metrics that define success in collections and dispute resolution. Keep in mind that everyone within the quote to cash process should have skin in the game. This includes sales, operations and customer service as well as the finance functions.

Report results and trends in a clear and action oriented format. Reports should help the reader identify issues where their help is needed. For example, it is interesting to report total Days Sales Outstanding (DSO) and to provide detail on the DSO current to terms, disputed and past due. Tie past due balances and major dispute issues to the specific customers or departments causing the problem or delay. This can be a real eye-opener to Senior Management who might not be aware of the impact of extended terms or the carrying cost of disputes.

Effective metrics:

- Days Sales Outstanding (DSO)
- Best Possible Days Sales Outstanding (BPDSO)
- Average Days Past Due (ADD)
- Past Due Ratio
- Collections Effectiveness Index (CEI)
- Specific Cash Targets
- Average Days to Resolve Deductions (DDO)

Utilize strategic outsourcing or insourcing and stick to core competencies that have a pay back. Review collection and reconciliation activity to find areas that are best outsourced to a competent third party. In these times of tight staffs and budgets, collection departments need to focus on critical customer relationships and transactions. Review low dollar activity, non-strategic accounts and seasonal volume fluctuations. These can be handled by a third party and will probably save the company money.

Provide incentives for targets to be met or exceeded. Incentives should be structured to include all who impact target achievement. This will also serve to bring different areas of the organization together as a team. Remember to have fun in the process. Targets should be a stretch but fair, achievable and be focused on group rather than individual performance.

Conclusion

To have a significant impact on incoming cash and collection results all parts of the organization must be devoted to the effort. Depending on the issue at hand, this could involve sales and marketing, operations, customer service, credit and collections, accounting and finance.

The company's credit and collection policies should address customer needs and the company's sales, and marketing and financial goals. Guidelines and exception policies should define acceptable terms of sale and credit risks. A mandate is required from senior management to make all this happen.

With the effective use of technology and leveraging internal and potentially outsource staff, the "holistic" approach can help identify root cause issues and lead to cross-functional efforts improve cost, efficiency, customer service, revenue opportunity and cash flow.

WHAT'S IN A NAME (cont.)

adopt unique standards. However, the International Association of Corporation Administrators has promulgated a set of Model Administrative Rules, available at www.iaca.org, that exemplify how small a margin for error may be provided by the new search logic based test for seriously misleading errors.

To illustrate, consider the following. Financing statement registries generally offer an online database that searchers can use to explore financing statements. A search under the debtor's name might display an alphabetical list with 20 entries, with the exact or nearest match at the top the list. To view additional results, the searcher can utilize "previous" and "next" buttons, which generally appear on the results screen.

For registered organizations such as corporations, the financing statements must list the name of the debtor as it appears in the public records of the jurisdiction state where it is organized. But, before the names are entered into an index, they are converted into a standardized format. Suppose the search logic, as the IACA's Model Rules suggest, ignores punctuation, accents, capitalization and spaces. Further, "noise words" are ignored so that "the", "and" or like words are also disregarded. In addition, abbreviations that indicate the nature of the organization, like "Corp.", "Co.", or Ltd.", are ignored. Thus, the presence of these types of errors will not render the statement ineffective. After the names are standardized, the computer conducts a search and produces a result based on exact matches between the search criteria and the database of filings.

If the debtor's correct name is "The Blakeley & Blakeley Company, the filing system would see the name as 'blakeleyblakeley.' If a secured creditor incorrectly listed the debtor's name as Blakeley & Blakeley LLC, the system would still see 'blakeleyblakeley' and the error would not be seriously misleading.

However, once the names have been modified by the search logic, the search will produce financing statements only if the names "exactly match". Thus, even a minor misspelling or a typographical error can be fatal. For example, under the prior law, spelling the debtor's name as Blakely & Blakely probably would not have rendered the filing ineffective under the "reasonably diligent searcher" test. However, under the

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WHAT'S IN A NAME (cont.)

Model Rules, such an error would render the security interest unperfected and susceptible to a "strong-arm" attack by the bankruptcy trustee.

In re John's Bean Farm

The case of In re John's Bean Farm of Homestead Inc., 378 B.R. 385 (Bankr S.D. Fla 2007) is another good example the new requirements harsh effect. In In re John's Bean Farm, the court was faced with deciding whether the financing statement filed by the creditor conformed to Florida's filing requirements or was seriously misleading. The court held that the incorrect name used on the financing statement did, in fact, constitute a seriously misleading financing statement.

In In re John's Bean Farm, the creditor loaned the debtor money to purchase equipment. The debtor defaulted so the creditor took a security interest in the equipment. However, the creditor's financing statement, as did all of his documents, identified the debtor as "John Bean Farms Inc." instead of the debtor's actual name of incorporation, "John Bean Farm of Homesead, Inc.".

The bankruptcy trustee objected to the claim and argued that the creditor's misidentification failed to comply with the rule governing the sufficiency of debtor names on financing statement, and therefore, the creditor's claim was unsecured. The creditor responded by arguing that the financing statement was not seriously misleading and was therefore adequate to perfect his interest in the debtor's equipment.

The trustee had conducted a search of the Florida Registry's online financing statement database using the debtor's correct name and did not find a match on the results screen listing 20 names. However, the creditor's financing statement was found after clicking the 'previous' button 60 times. The creditor attempted to argue that a searcher must go beyond the first page of the search result, however the court disagreed - noting that if the creditor's view is correct, then 'search result' means something other than what the search page displays.

Scrolling through pages upon pages of results is exactly what Revised Article 9 was intended to prevent. While the court stated that the purpose of Revised Article 9 was "to create a framework for the perfection of security interests that is less arbitrary, that includes statutory guidance of simplifying the search, while allowing or 'minor' errors", it did explain that if it were to interpret revised Article 9 to avoid an absurd result, then a "reasonable limit to the search would be no more than one 'previous" or "next" screen after the initial search input.

Conclusion

In summary, it is vital to be especially careful when filing financing statements. Any error, whether careless or inadvertent, in naming the correct entity on the financing statement could potentially result in a secured creditor's claim becoming characterized as an unsecured claim. What, then, practically speaking, is the best practice for a company to reduce this risk? The credit executive selling on a secured basis simply must not only make sure they properly record their financing statement using the debtor's exact legal name but must also ensure that, given the particular search logic used by the local records office, the filing is easily located. In addition, a vendor must remain vigilant with regard to staying "perfected". A vendor's failure to file an amended UCC-1 financing statement after a debtor corporation has changed its name, for example, could result in that vendor's financing statement being "seriously misleading" – thereby creating a risk that the bankruptcy trustee can unseating the lien. As a result, the secured creditor might not be able to obtain full recovery on the claim if the estate is administratively insolvent. So… what's in a name? Well, when trying to perfect a security interest under Revised Article 9, "that which we call a debtor by any other name definitely does not smell as sweet."

VENDORS AND SUPPLIERS OF THE BIG THREE (cont.)

sending disastrous, and unacceptable waves throughout the U.S. economy. A vendor or supplier must be aware of the potential impacts a bailout or bankruptcy could have on their business, and be prepared to make tough decisions regarding the relations with the Big Three if one does file for bankruptcy.

Vendors and Suppliers linked to the Big Three

GM alone has fifty-four North American manufacturing plants, at least 4,000 Tier-I suppliers, and has impacts on many more suppliers and partsmakers across North America. Figures show that jobs tied to the Big Three and related partsmakers and suppliers totals around 1.2 million.

Vendors and suppliers of the Big Three could see drastically different results in their bottom line and operations depending on whether a bailout from Capitol Hill will be forthcoming and must be prepared to work with the Big Three if they want to see long-term survival of the giants.

The Bailout

The carmakers believe that they will need an estimated $50 billion in taxpayer support to make it through the downturn in the economy, and seek an advancement of the $25 billion already promised for alternate fuel development. The Big Three want to use the $25 billion to pay for general expenses.

A bailout would allow the U.S. automakers to keep making payments to vendors and suppliers despite their mounting quarterly losses. However, opponents to the federal assistance see the money as a blank check, which would not force substantial changes in the Big Three, and therefore no changes in the companies' fundamentals. Suppliers may be able to receive payment via the bailout for 2009, but in 2010? Or, 2011?

Bankruptcy

Without a bailout from the Federal Government, bankruptcy would be the apparent solution to the growing problems in Detroit. Corporate bankruptcy generally provides legal protection to a faltering company, blocking out creditors while specialists attempt to return the business to profitability. This allows for renegotiation of loans and the modification of contracts, many of which are with vendors and suppliers.

GM, trying to reorganize under Chapter 11 of the Bankruptcy Code, would be forced to restructure beyond just eliminating or selling off unprofitable lines of business. The company would require significant amounts of capital throughout the restructuring process, and would involve substantial investment in the automaker. It is estimated that it will cost GM $15 billion to close more plants, compensate redundant workers and dump some of its lesser performing brands.

It is possible that GM could find that the most cost-effective way of reorganizing in a prepackaged bankruptcy. A prepacked bankruptcy could end up saving billions of dollars for the company and allow them to reemerge from bankruptcy faster than if the bankruptcy was not prepackaged. In a prepackaged bankruptcy, an automaker would

(Continued on page 13)

VENDORS AND SUPPLIERS OF THE BIG THREE (cont.)

go into court with financing in hand after reaching agreement with lenders, workers and suppliers on what each would give up and on the business plan to be followed. The process might take six to 12 months, compared with two to five years if the automakers followed an ordinary Chapter 11 proceeding and worked out agreements under a judge's supervision.

In an era where financing a company during bankruptcy has become a risky proposition, GM entering bankruptcy with known sources of funding would allow the giant to have less concerns about liquidity during the bankruptcy proceedings and would allow them to reemerge restructured and hopefully profitable much sooner.

A supplier of one of the Big Three takes the risk in agreeing to work with the automaker in a prepackaged bankruptcy. With many suppliers' fate tied to the Big Three, agreeing to work out payment schedules before the company enters into bankruptcy could give the best opportunity for longevity of the Big Three and the businesses that depend on them.

If GM entered into a normal Chapter 11 scenario, the process can often be long and drawn-out. This forces vendors, suppliers, and other creditors to seek payment through the bankruptcy proceedings, often receiving substantially less than was due under the contract, and sometimes nothing at all. Further, the current credit crisis has created a situation where no one wants to hold debt of companies whose prospects are in doubt.

As seen with the recent Chapter 11 filing of Linens 'N Things, if a company cannot secure the capital necessary to continue operations during the restructuring process, it may look to liquidation as the only option. A liquidation of a major automaker is more than just selling stocks of cars and trucks, but could potentially cause a chain reaction of failures to dealers, suppliers, vendors, and service stations. Moreover, the autoparts industry, heavily tied in with a particular automaker, could be severely impacted.

Conclusion

Over the next year, the Big Three face tough challenges to revamp their product, change corporate philosophies, cut costs, and attempt to maintain afloat during increasingly difficult times. Vendors and suppliers must be aware of the potential consequences of inaction from Washington D.C. and must be prepared and willing to work with the automakers if a bailout is not forthcoming. If a major U.S. automaker enters into a bankruptcy proceeding, the vendors and suppliers will undoubtedly take losses, however willingness to work with the Big Three could be what saves the American automotive industry. Lenders and suppliers, in agreeing to a prepackaged bankruptcy will be choosing to risk short-term payments for the overall health of their business and the industry.

GETTING YOUR LENDER'S SUPPORT IN THESE FINANCIALLY UNCERTAIN TIMES (cont.)

from your customers depending on the project size.

Perform weekly reviews of your accounts receivable and identify potential collection problems. Talk and or meet with your customers frequently. If your customer is in financial difficulties, confirm that you are complying with the lien laws and rights to possibly suspend work. For public companies visit their web site and keep current with their public filings, watch for stock price fluctuations and their press releases on new or lost customers or projects. For private companies watch for such things as an increase in credit references, whether the customer is providing you with current financial information, investigate whether lawsuits have recently been filed and increase in liens that are being filed.

Consider the need for credit enhancements, such as performance bonds and accounts receivable insurance. Discuss this with your lender. These costs should then be included in your bids. Also make sure that you have the proper procedures in place in the event that you have performance bonds or accounts receivable insurance.

In negotiating your contract with your customer try to get the minimum billing cycle as possible and follow through and do the timely billing. In the event that liens must be recorded for protection have procedures in place to make sure they comply with state requirements as they vary from state to state.

Your forecast should be conservative. Include all significant assumptions used in preparing the forecast. It is always better to do better than you forecasted and easier to discuss with you lender. If you expect significant changes discuss them with your lender.

Don'ts

If you are aware of bad news don't try to hide it from your lender. The lender will eventually learn about it. You must keep your credibility with your lender.

Don't assume that all of your safeguard procedures are being performed. Set up a monitoring system to insure compliance.

Don't ignore calls from your lender.

In conclusion, the marketplace is a tough one. But having a close relationship with your lender can help you through these times and you may set once the market turns.

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