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A Newsletter of Current Business and Legal Matters

In This Issue:

Managing Your Company's Financial Strength in a Growing Economy

By James R. Vann

Every company encounters challenging economic times due to the economy. Keeping a watchful eye on financial strength in a growing economy is as important as any other time. Managing the receivables, payables and cash flow of your business are key components to the overall financial health of your business. It can be difficult but it is possible to manage the unexpected issues which arise from time to time as well as the impact from the economy.

Stay Focused on Positive News: An owner/entrepreneur and the management team can accidently get caught in focusing on the bad news circulated in the media regarding the economic environment. It is important to listen and study the economic news and to respond to it accordingly. It is even more important to focus on the positive aspects of your business and not allow the negative news to divert your attention from growing and managing your revenue and financial strength.

Focus on Profitable Service to Your Customer: Make certain that the higher profit areas of the business remain focused on providing "memorable service to the customer". There may be areas of the business which generate only a small portion of profit compared with other areas. Make certain that the business remains focused on servicing the customer.

Manage Payables and Receivables More Often: If cash flow becomes a challenge, it may be necessary to bill faster (15 days instead of the end of the month) in order to generate revenue faster. Likewise, if you notice customers are paying slower, it may be necessary to touch base with the customer earlier than normal to determine the facts for the slower pay and respond accordingly.

Manage Cash Flow: In a growing economy, typically cash flow can fluctuate quickly. With the need to buy more inventory, hire new employees, invest in new equipment, all these items put a strain on cash flow. It is important to keep a close eye on cash flow and closely monitor cash needs.

Remaining focused on generating revenue, increasing profit, managing payables and receivables will surely increase your financial strength. Do your best to remain positive and focus on the good economic news! Avoid the temptation to get pulled into areas of high risk. Now is a great time to improve your financial strength!

How to Manage Bankruptcy Issues as a Creditor (Preferential Transfers in Bankruptcy: How to Minimize the Preference Risk)

By James R. Vann

For suppliers of goods and services, nothing may be more unsettling than discovering that a customer has filed for bankruptcy. To add insult to injury, there is a risk that any recently received payment or settlement might be recaptured by the bankruptcy trustee as a preferential transfer or "preference." Do not give up on issues in bankruptcy thinking that creditors cannot win in bankruptcy court. Approach the process with the thought and goal of winning!

Fortunately, there are defenses that can be raised against preference claims. Creditors should be aware that there are contexts in which payment can be extracted from a debtor without fear that the transfer will be avoidable at some future date. Below, is an overview of the criteria that give rise to bankruptcy preferences, and also highlight some common defenses available to creditors in preference actions.

What is a "preference" payment?

Section 547 of the Bankruptcy Code governs preferences. Under this section, a trustee or debtor-in-possession may recover – as "preferences" – any payments or other transfers of assets by a debtor to a creditor within 90 days of the debtor's bankruptcy filing. There are two main purposes for this policy: to prevent a debtor from favoring any of its general unsecured creditors over the others; and to discourage creditors, upon hearing that the debtor is about to file bankruptcy, from storming the courthouse to collect their individual debts.

The elements of a preference claim are typically stated as follows: (1) the debtor transferred property to or for the benefit of the creditor (i.e., made a payment); (2) the transfer was made on account of a debtor's pre-existing debt to the creditor; (3) the debtor was insolvent at the time of the transfer; (4) the transfer was made within 90 days of the debtor's bankruptcy filing, or within one year if the creditor is an insider on account of an old debt; and (5) the creditor obtained a larger sum from the transfer than it would have in a Chapter 7 liquidation had the transfer not occurred. Note that payments to a fully secured creditor fail to meet these criteria, as the secured creditor won't receive any more from the debtor than the value of the collateral, which is what it would receive in bankruptcy.

Common Preference Defenses

The bankruptcy code provides a series of defenses that creditors can assert to evade preference treatment. These defenses are primarily aimed at encouraging creditors to continue doing business with financially troubled companies. Some of those most frequently asserted are: (1) the contemporaneous exchange for new value defense; (2) the ordinary course of business defense; and (3) the small transfer defense. If a creditor is to routinely evade preferences, a working knowledge of these defenses is imperative.

1. The Contemporaneous Exchange for New Value Defense

The contemporaneous exchange defense is codified at Section 547(c)(1) of the Bankruptcy Code. It excuses any payment or other transfer that the debtor and creditor intend as a contemporaneous exchange for new value, and that is, in fact, a substantially contemporaneous exchange. In other words, if a creditor provides new goods and/or services and receives payment at substantially the same time, the payment will not receive preference treatment. An example of such a contemporaneous exchange would be payments received on a C.O.D. basis.

2. The Ordinary Course of Business Defense

Under Section 547(c)(2) of the Code, payments received in the ordinary course of business on debts incurred in the ordinary course of business are excepted from preference treatment. A creditor may utilize the ordinary course defense in either of the following contexts: (1) where payment is received in its ordinary business with the debtor, or (2) where payment is received according to the ordinary business in that industry.

As to the first test, the court's basic inquiry involves a subjective evaluation of the debtor/creditor relationship. This generally takes the form of a consideration of the length of time the parties have had a business relationship, and whether the amount or form of payment at issue differed from past business practices between the parties. The longer the business relationship, and the lesser the difference between the payment history before the preference period and that within the preference period, the greater the likelihood that the supplier will prevail.

As to the second test, a more objective inquiry is utilized. The supplier must establish that the terms by which it extended credit to the debtor were "ordinary" within industry standards. This does not mean that all invoices are required to be paid within the invoice terms. The creditor need only show that payments are made sporadically or outside invoice terms in the particular industry involved, or at least in a manner and form consistent with the payment practice being challenged.

3. The Small Transfer Defense

This defense bars preference claims in the case of primarily non-consumer debt for payments of up to $5,000. Creditors should keep this ceiling amount in mind when structuring payment from debtors. As a matter of strategy, creditors may prefer payments of $4,999 to payments not appreciably greater than that amount. However, a caveat is in order: any payments received during the 90-day preference period cumulate against the maximum protected amount. Thus, if a monthly payment schedule is in place, the $4,999 maximum must be distributed amongst the preceding three months.

Conclusion

Often, bankruptcy trustees will file preference claims against all creditors who have received payment from the debtor in the 90 days immediately preceding a bankruptcy filing. The strategy is to file the claims upfront, and then sort out the merits later in the process. A basic understanding of preferences can help creditors avoid making a reflexive, yet unnecessary, refund payment. Nonetheless, as demonstrated by the cursory outline above, these matters can be complex and are best addressed with the assistance of a lawyer with experience representing creditors in bankruptcy cases. More importantly, do not give up on issues in bankruptcy thinking that creditors cannot win in bankruptcy court. Approach the process with the thought and goal of winning!

If you have questions or need assistance, please feel free to contact us.

Chasing the Money - Corporate Officers' Personal Liability

By James A. Beck

When a creditor seeks to secure its future ability to collect an account, it may be able to obtain a personal guaranty from an owner or officer of a corporation. Many times, however, that elusive personal guaranty is not obtained, or for one reason or another, is unenforceable. When a corporation is dissolved or ceases to conduct business, the creditor is out of luck with respect to collecting funds from that corporation. In such situations, perhaps there are other ways to hold an individual responsible for a corporate debt.

Generally, a corporate officer is not liable for the debts of the corporation. This standard rule is the main reason why people incorporate their businesses. Courts have upheld this protection for officers in contract and in tort cases. However, there are some exceptions to this rule that could benefit a creditor trying to recover what would otherwise be an uncollectable debt. Before giving up hope, it is necessary to carefully investigate to determine if one of the exceptions applies.

In a tort case, such as a situation where a claim for negligence has been asserted, a corporate officer could be held liable if he committed the tort personally or otherwise participated in the wrongful act. For example, if a party asserted a fraud claim against a corporation and an officer, the officer could be held liable if he or she personally committed an act establishing the fraud. If, on the other hand, the officer had no involvement in committing the fraudulent act, he or she would not be responsible.

If a creditor's claim lies in the contract, then the analysis changes. Again, the general rule applies, but the exception to the rule requires a different investigation. Case law in North Carolina has made it clear that an officer can be held responsible for the debts of a pretended corporation. This means that in the event a corporation's charter has been suspended, an officer can be liable for the debts incurred during that suspension if he knew the charter had been suspended. Further, a corporation that has been dissolved does not exist. As such, the officers conducting business under the name of a dissolved corporation are directly responsible for debts incurred in the course of business.

In addition to pursuing corporate officers, there are steps that can be taken to recover against defunct corporations and limited liability companies, and each situation calls for a review of the facts and circumstances particular to that entity and its activities.

Corporate entities come and go, but individuals stay the same. Naturally, a creditor is much better off if able to pursue the recovery of a debt from an individual. If you need assistance in determining whether you or your business can pursue an individual for an otherwise bad debt, contact us. We would love to hear from you!

North Carolina Supreme Court Limits Defenses Available for Foreign Judgments

By Joseph A. Davies

The Uniform Enforcement of Foreign Judgment Act (UEFJA) provides a streamlined method for enforcing a judgment from another state in North Carolina. In DocRx v. EMI Services of North Carolina, LLC, the Supreme Court determined that the Full Faith and Credit Clause of the United States Constitution limits the defenses available to the enforcement of an out-of-state judgment. In plain English, the Full Faith and Credit Clause requires one state to treat another state's judgment exactly as it would its own – a judgment properly obtained in a court in Nevada must be recognized by the courts in every other state – including North Carolina. The North Carolina legislature adopted a framework for entering out-of-state judgments – the UEFJA. That framework allows the judgment creditor to file the foreign judgment and gives the judgment debtor a limited time to object to the entry of that judgment in North Carolina. Prior to the court's recent decision, it was uncertain exactly what objections the judgment debtor could make. The Court determined that the judgment debtor cannot object on any basis regarding the merits of the underlying lawsuit, but may only raise defenses against the enforcement of the judgment. Some examples of such defenses are that there was some fraud in the act of obtaining the judgment, that the out-of-state court lacked jurisdiction, or that the judgment has been paid or settled. The UEFJA is a powerful tool for enforcing judgments from other states in North Carolina – the Court's decision in the DocRx case helps ensure that it will remain an efficient one.

Employment Policy Needed To Address Mobile Phone Usage While Driving

By James R. Vann

In North Carolina, effective December 1, 2009, it became unlawful to drive a motor vehicle and use a mobile telephone or other similar digital technology for email, texting, access to the internet or games.

The Law

The law sets forth limitations as to what type of electronic information is or is not allowed while driving. The law makes it unlawful to:

- Manually enter multiple letters or text as a means of communicating with another person; or
- Read any electronic mail or text message sent or stored;
- However, this limitation does not apply to any name or number stored in the mobile telephone or other digital device nor to any caller identification information.

Thankfully, the prohibitions of this law do not apply if your motor vehicle is parked or stopped. This raises the question as to whether you can text and email while your vehicle is stopped at a traffic sign or traffic light. The law also is not applicable to emergency personnel. The law does allow the use of global positioning systems or wireless communication devices used to send or receive data as part of a digital dispatch system. The law also allows the use of voice-operated technology which will grow in popularity.

The Need for an Employment Policy

Restricting the use of technology for sending and receiving text messages, emails, and other similar communications while driving makes sense. As a business concern, you need your employees to be accessible while out of the office. Email and/or texting are obviously easy ways to stay in touch. However, safety requires more concentration to driving.

The concern for employers is potential liability. There have been multiple accidents across the country where one or more of the drivers were accessing text messages or emails while driving. This has become and will remain a likely source of liability for employers.

Employers should have a comprehensive written policy which addresses the use of electronic communications while driving on behalf of the employer. After the policy is adopted by the employer, the policy should be properly communicated to all of the employees and consistently enforced.

If you have questions or would like us to assist you concerning how to create and enforce a policy to cover the new law, feel free to contact us.

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