BUSINESS CREDT PROFESSIONALS, GUIDE TO THE ABC's OF LEGAL TERMINOLOGY

When MACS Worldwide asked me to contribute articles on a continuing basis in support of their new monthly executive summary, it occurred to me it might be helpful to describe the extent to which credit professionals are exposed to legal issues as part of their daily duties. Senior executives of companies may not be familiar with creditors legal terminology and how those matters can influence a business. It is not an over statement that a company's credit department has more exposure to legal matters than most other departments. Some credit professionals comment that their legal department will often approach them with questions on bankruptcy and specific creditor's rights issues. So here we go.

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A

"Accord and Satisfaction" is where the debtor seeks to discharge a disputed or unliquidated obligation by delivering a check "in full settlement," "in full satisfaction" or" in full payment" or similar verbiage of the debtor's obligations to the creditor. A creditor could try to avoid an accord of satisfaction by including, with their endorsement of a full payment check, such language as " under protest," without prejudice" and/or "with full reservation of rights." However, the courts have reached conflicting decisions on the sufficiency of such language to a void an accord and satisfaction.

"Antitrust" is federal and state law intended to enhance competition. The federal statutory framework consists of, among other statutes, the Sherman Antitrust Act of 1890, the Clayton Act of 1914, as amended by the Robinson-Patman Act of 1936, and the Federal Trade Commission Act of 1914. Antitrust law precludes any contracts, combinations, conspiracies or other activity "in restraint of trade" or resulting in "price discrimination". Antitrust law could be implicated in fixing or changing prices and/or credit terms. Any violation of applicable antitrust law could result in civil and, in some instances, criminal liability.

"**Assignment for the Benefit of Creditors"** is a state law liquidation proceeding. The debtor assigns all of its rights to its assets to a third-party assignee. The assignee holds all of the debtor's assets in trust for distribution to creditors based upon the priority of their claims as determined by state law.

"**Automatic Stay"** arises when a debtor files a petition for relief under the Bankruptcy Code. The automatic stay gives the debtor a "breathing space" by preventing creditors from commencing or continuing a lawsuit, entering or enforcing a judgment, terminating contracts and/or taking any other action to enforce payment of their claims. (Under US Bankruptcy Code, 301- Voluntary Petition, 302 – Joint Petition and 303 – Involuntary Petition)

B

"Bankruptcy Code" or Title 11 of the United States Code is the current codification of United States bankruptcy law. A debtor can file for relief under Chapter 7, the liquidation chapter, where a trustee is appointed to liquidate the debtor's assets and reconcile claims: Chapter 11,where the debtor's management continues to operate the debtor's business and remains in possession of the debtor's assets and the goal is the rehabilitation of the business and resolution of treatment of creditors' claims in a Chapter 11 plan approved by the bankruptcy court; Chapter 12, dealing with family farmers and fishermen; Chapter 13, dealing with individuals with regular income and Chapter 15, dealing with cross-border insolvency cases.

C

"Contract" is an agreement between two or more parties where they are required to perform or forbear from performing in a specified manner. A contract can be explicit (written) or verbal (implied). A legal contract requires four key elements: an offer, acceptance, mutuality of assent and consideration. Contracts with minors are voidable.

"**Check"** is a draft (negotiable instrument) drawn on a bank and is payable on demand.

"Corporation" is an artificial legal entity that is created under state law, has a perpetual life and is separate and apart from its officers, directors and shareholders, none of who, as a general rule, are liable for corporate obligations.

"**Consignment"** is governed by Article 9 of the Uniform Commercial Code, (and, therefore, subject to its UCC filing requirement) which defines a consignment as the delivery of good having a value of at least $1,000 to a merchant for sale provided (a) the transaction does not create a security interest, (b) the goods are not "consumer goods" immediately before delivery, (c) the merchant deals in goods of that kind under a name other than that of the consignor, is not an auctioneer and is not generally know by its creditors to be engaged substantially in selling the goods of others and (d) the transaction does not create a security interest. A consignment is like a purchase money security interest in that the consignor could obtain a priority in the consigned goods over the consignee's floating lien secured inventory lender by following the purchase money security interest requirements contained in UCC Article 9.

"Creditors' Committee" is appointed by the United States Trustee in Chapter 11cases from the largest unsecured creditors willing to serve. The Creditors' Committee is the representative of all unsecured creditors and, among other activities, exercises oversight over the debtor, investigates the debtor's assets, liabilities, business operations and financial condition and negotiates a Chapter 11 plain that governs the treatment of creditors' pre-petition unsecured claims.

D

"**Discharge"** (in bankruptcy) is one of the reasons and motivations for a debtor's bankruptcy filing by relieving the debtor of certain specified obligations and thereby granting the debtor a " fresh start".

E

The **"Equal Credit Opportunity Act" ("ECOA")** prohibits a creditor, in its credit decisions, from discriminating based upon, sex, marital status, race, color, national origin, religion and age. The ECOA, together with Regulation B, adopted by the Federal Reserve Board, imposes obligations on business creditors in connection with any adverse action taken in connection with a credit decision, including notification and record retention requirements.

The **"Electronic Signatures in Global and National Commerce Act" ("E-SIGN")** is a federal stature that governs the creation of an electronic contract under which an electronic signature would be legally enforceable, thereby binding the executing party to the terms of the contract.

"Escheatment" deals with the obligations of a company in connection with the unclaimed property of a third party, including unclaimed credit balances

"Exemptions" permits an individual debtor to protect certain items of his or her property from seizure by creditors or inclusion in the debtor's bankruptcy estate. A debtor in bankruptcy could choose between the state or Bankruptcy Code exemptions, unless the state of the debtor's domicile for a certain period opts out of the bankruptcy exemptions, in which event the state law exemptions govern.

"Executory Contract" is a contract (such as long-term agreement to provide goods and/or services) where performance remains due to some extent on the part of the contract parties and the failure of a party to perform is a material breach that excuses the other party's performance of the contract. The Bankruptcy Code prescribes the rights and obligations of parties to executory contract.

F

The **"Fair Credit Reporting Act" ("FCRA")** regulates the use of consumer credit reports and in particular, when a credit grantor could or could not obtain a consumer credit report of an individual applicant without his or her written consent.

The **"Fair and Accurate Credit Transactions Act of 2003" ("FACTA")** regulates disposal of personal information obtained from consumer credit reports, including social security numbers, banking information, addresses and telephone numbers, all with a view toward protecting against "unauthorized" access to, or use of, consumer information.

G

"Guarantee" is an agreement to pay the obligations owing by a third-party.

I

"Incoterms" a/k/a "International Commerce Terms" developed by the International Chamber of Commerce, which describes them as a "standard trade definitions most commonly used in international sales contracts." Of the 13 different Incoterms, the best known are: EXW (Ex works), FOB (Free on Board), CIF (Cost, Insurance, and Freight), DDU (Delivered Duty Unpaid) and CPT (Carriage Paid To).

"Insolvency" is defined differently under the Bankruptcy Code and the Uniform Commercial Code. The Bankruptcy Code defines insolvency based upon the balance sheet definition: liabilities exceed assets; The Uniform Commercial Code defines insolvency based upon either a balance sheet or an equity test. A debtor is insolvent under the equity test when it ceases to pay its debts in the ordinary course of business or is unable to pay its debts as they became due.

J

"Joint Check Agreements" are frequently used by subcontractors and materials/services suppliers for real estate construction projects to increase the likelihood of payment by a financially troubled customer. Under a joint check agreement, the project owner agrees to make payment jointly to the contractor and the subcontractor to insure payment of the subcontractor's invoices. Alternatively, the general contractor agrees to make payment jointly to the subcontractor and materials/services supplier to assure payment of the supplier's invoice.

“**Judgment**” is a court determination of the rights and obligations of the parties to a litigation, including a creditors right to collect a specified sum plus interest from the debtor. A judgment creditor must take additional action specified under state law to enforce the judgment and/or obtain a judgment lien in the debtor’s assets.

K

“**Key-Man Insurance**” is insurance coverage purchased by companies for protection from the death or disability of a critical employee or to fund a buyout of the interest of an owner upon death or disability.

L

“**Letter of Credit**” is the independent obligation of a third party, usually a bank to make payment upon the letter of credit beneficiary’s presentation of documents that comply with the letter of credit. A letter of credit transaction involves three separate contracts, each of which is independent of the other. The first contract relates to the transaction that the letter of credits is intended to backstop, such as the contract between a seller and buyer for the sale of goods or provision of services. The second contract is the contract between the letter of credit applicant and its bank for the issuance of the letter of credit in favor of the letter of credit beneficiary. The third contract is the letter of credit itself. The seller/beneficiary of a documentary letter of credit looks to the issuing bank for payment by presenting the required documents, such as documents evidencing the sale of goods or provision of services. The seller/beneficiary of a standby letter of credit first looks to the other contract party for payment and upon the latter’s default, seeks payment from the letter of credit issuing bank by presenting the required documents evidencing the default.

“**Lien**” is an interest in real or personal property to secure payment of a claim. A lien arises either consensually or non-consensually. A consensual lien includes the debtor’s granting the creditor a security interest in certain or all of the debtors personal property, usually by entering into a security agreement with the creditor, and protecting the security interest as against third parties, such as judgment creditors and a bankruptcy trustee, by filling a UCC financing statement in the required jurisdiction. A nonconsensual lien arises without the debtors consent, and includes statuary liens. Such as artisans’, processors’, warehouse, landlords’, and mechanics’ liens, that arises under state or federal law and attaches to the debtor’s personal and/or real property to secure he debtor’s obligations to a particular class of creditors.

“**Limited Liability Company**” is similar to a corporation in that the owners and management are not subject to the company’s liabilities. However, a limited liability company differs from the corporation by enjoying the pass-through tax benefits of a partnership, and thereby, avoiding the double taxation to which a corporation is subject.

M

“**Mechanics Lien**” is a state law statutory lien that grants suppliers of goods and services for real estate construction projects, a lien in the land, the building or other improvements erected on the land. Mechanics’ lien statutes and the timing and requirements for the creation and perfection of a mechanics lien vary from state to testate.

“**Miller Act**” is a federal statute that requires general contractors on a federal project to furnish payment bonds to protect suppliers of work or materials to such projects. Many states have similar statues.

N

"Novation" discharges a party from any continuing obligation to perform under a contract, contingent upon the agreement of the other party to the contract. Novation usually provides for a third-party's assumption of a discharged party's obligations under the contract.

O

"Offer" initiates the formation of a contract by one party communicating a willingness to enter into the contract subject to the other party's acceptance of the offer.

"**Out of Court Workout**" is an agreement between the debtor and a group of creditors that governs the treatment of the consenting creditors' claims without the necessity for a Chapter 11 filing and a Chapter 11 plan.

P

"**Partnership"** is an entity created by agreement among two or more persons that is not a corporation or limited liability company. The general partner is liable for all of the debts of the partnership. A limited partnership has a general partner who is liable for all of the debts of the partnership, and limited partners, who are not liable for partnership debts.

"**Chapter 11 Plan"** sets forth the classification and treatment of a Chapter 11 debtor's claims, the means of execution of the plan, the discharge of creditor's claims, other than as set forth in the plan, and other provisions. Confirmation or approval of a plan by the bankruptcy court is the goal of the Chapter 11 process and is contingent on the plan proponent's satisfying certain requirements.

"Preference" is a payment or other transfer of assets of a debtor to or for the benefit of a creditor on account of antecedent or existing indebtedness made within 90 days of the filing of a bankruptcy petition for non-insider creditor recipients (such as a trade creditor) and within one year of bankruptcy for insider creditor recipients (such as officers, director or controlling shareholders and affiliates of a corporation), when the debtor is insolvent (balance sheet definition: liabilities exceed assets, which is presumed during the 90-day preference period) and that results in the creditor/recipient receiving more than in a Chapter 7 liquidation. A trustee or debtor-in-possession that proves all of the elements of a preference claim can recover the preference form the creditor unless the creditor asserts certain specified defenses to reduce or eliminate preference exposure, such as ordinary course of business, contemporaneous exchange for new value ("COD") and a new value defenses.

"**Proof of Bankruptcy Claim"** as a general rule, must be filed by general unsecured creditors, setting forth the amount of the claim as of the bankruptcy filing date and the basis for the claim, prior to any applicable deadline, in order to participate in any distribution of the debtor's assets and/to vote in any Chapter 11 plan.

"**Purchase Money Security Interest**" ("PMSI") is a security interest granted by the debtor to (i) a supplier of goods for the purchase price or (ii) a third-party lender for value given to enable the debtor to purchase the goods. A close nexus is required between the acquisition of the goods and secured obligation. Thus, a security interest does not qualify as a PMSI if the debtor acquires the goods on unsecured credit and subsequently creates the security interest to secure the purchase price. A PMSI is entitled to super-priority status with priority over an earlier-filed security interest covering the goods as after-acquired property if the PMSI creditor satisfies certain requirements specified in UCC Article 9.

…To be continued