Loose Lips Sink Ships

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ASCEND PERFORMANCE MATERIALS
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Date: June 13, 2016
Time: 3:45pm – 5:00 pm
Session Number: 25032
LOOSE LIPS AND SMOKING GUNS
RE: CREDIT EXCHANGE:
BEWARE OF
ANTITRUST CLAIM RISK
Trade Credit Groups – Avoiding Antitrust Risks

- Exchange of Information Regarding Credit Worthiness of Customers is Linchpin of Trade Credit Groups
  - Key Point: Exchange cannot violate antitrust statutes
- Sherman Antitrust Act of 1890 –
  - Prohibits contracts, combinations and conspiracies in restraint of trade in interstate or foreign commerce
  - Prohibits monopolies
- Clayton Act of 1914
  - Prohibits specified types of prohibited transactions designed to restrain trade, or lessen competition
- Federal Trade Commission Act of 1914
  - Prohibits unfair competition and unfair deceptive acts
- Antitrust Procedure and Penalties Act of 1976
- State Antitrust Statutes

Activities Prohibited By Antitrust Laws

- Price Fixing
- Bid Rigging
- Exchanges of Price Information
  - U.S. Supreme Court has ruled that price includes credit terms
- Group Boycotts
- Dividing Territories/Customers
- Resale Price Maintenance
- Monopolization
- Price Discrimination
Permissible Trade Credit Group Discussions

• The Courts Have Upheld the Exchange of Credit Information If All Participants in Such Exchange Can Make Independent and Unilateral Credit Decisions

• Permissible Conversations
  – “Historical, Factual, Unemotional”
  – List of delinquent accounts
  – Exchange of factual credit information
  – Past transactions, but be careful not to get into future action
  – Placement for collection
  – Initiation of lawsuit
  – Judgment obtained

Non-Permissible Discussions

• Be Careful to Avoid Conduct That May Create Antitrust Risks

• Non-Permissible Conversations
  – Pricing/Credit terms
    • Okay to discuss past and completed credit transactions
  – Future action re account
    • “Let’s put the bum out of business”
    • Risk of boycott claim
  – Side conversations/whispering involving a few members
  – Risk of guilt by association based on improper conduct by other members
  – Avoid taking notes – They are discoverable in a future litigation
  – Discussions about accounts outside of meeting
References

- Antitrust Rules also Apply to:
  - Request for references
  - Giving references
- “Historical, Factual, Unemotional”
  - Date account opened
  - Date of last sale
  - Recent high credit
  - Amount outstanding: $ current; $ 30 days past due; $ 60 days past due
- A No-No
  - Sharing your terms
  - Use of ambiguous terms such as “unsatisfactory”, “prompt”, “slow”

Participating in Involuntary Bankruptcy While Reducing Antitrust Risk

- Avoid group discussions about involuntary petition
- Avoid group discussions about “appropriate” credit treatment of Debtor by individual Creditors
- Retain attorney
- Have attorney contact other Creditors
- Petitioning Creditors must each make independent decision whether to join involuntary petition
- Risk if done wrong: seen as group boycott
- Group boycott is per se illegal, like price fixing
Participating in Chapter 11 Creditors’ Committee

- Creditors’ Committee members’ qualified immunity for actions within scope of official committee duties
  - No immunity for improper collective actions
- Same rules apply as when participating in credit group
- Avoid improper group discussions
  - Pricing
  - Credit Terms
  - Other individual creditor future conduct towards Debtor
  - War stories
RISK OF INAPPROPRIATE INFORMATION REQUESTED IN CREDIT APPLICATION OR CONTAINED IN FILE
Inappropriate Information In File

• Comments about an Individual at Customer’s Company Considered as Opinion or Open to Interpretation

• Notes of Credit Group Meeting Discussion about Customer; such as
  – “ABC Co. used to sell to customer on open account, but is now CIA only. Watch them close and put them on CIA if they miss a payment”
  – Creditor’s switch to CIA on sales to customer could be construed as not acting independently, but instead following ABC Co’s lead

Risk Of Defamation Claims

• Defamation – Oral or Written Statement About a Person That Is
  – Defamatory
  – False
  – Published (communicated to other third parties)
    • E-mail
    • Informal comments at lunch, over drinks or over phone
  – Diminishes person’s reputation
Inappropriate Information In File

- Comments About an Individual Customer’s Company considered Opinion or open to Interpretation
- Potential Defamatory Statements
  - Customer never pays bills
  - Customer constantly fails to pay bills on time
  - Customer is a financial deadbeat
  - Customer is a poor credit risk
  - Customer is a “thief”/crook
ADVERSE ACTION/CONSUMER CREDIT REPORTS ON INDIVIDUALS SPousAL GUARANTEES “ECOA” “FCRA”
ECOA Notices

- ECOA Prohibits Discriminating with Respect to Credit Extension/Renewal
  - On basis of gender, marital status, race, color, religion, national origin, age, welfare assistance
  - Implemented by Regulation B [12 CFR 202 of Federal Reserve Board]

ECOA: Notice To Include In Application

- THE FEDERAL EQUAL CREDIT OPPORTUNITY ACT PROHIBITS CREDITORS FROM DISCRIMINATING AGAINST CREDIT APPLICANTS ON THE BASIS OF RACE, COLOR, RELIGION, NATIONAL ORIGIN, SEX, MARITAL STATUS, AGE; (PROVIDED THE APPLICANT HAS THE CAPACITY TO ENTER INTO A BINDING CONTRACT); BECAUSE ALL OR PART OF THE APPLICANT’S INCOME DERIVES FROM ANY PUBLIC ASSISTANCE PROGRAM; OR BECAUSE THE APPLICANT HAS IN GOOD FAITH EXERCISED ANY RIGHT UNDER THE CONSUMER CREDIT PROTECTION ACT. THE FEDERAL AGENCY THAT ADMINISTERS COMPLIANCE WITH THIS LAW CONCERNING THIS CREDITOR IS FEDERAL TRADE COMMISSION, EQUAL CREDIT OPPORTUNITY; WASHINGTON, D.C. 20580.
ECOA: Notice To Include In Application

• IF YOUR APPLICATION FOR BUSINESS CREDIT IS DENIED, YOU HAVE THE RIGHT TO A WRITTEN STATEMENT OF THE SPECIFIC REASONS FOR THE DENIAL. TO OBTAIN THE STATEMENT, PLEASE CONTACT (NAME, ADDRESS AND TELEPHONE NUMBER OF THE PERSON OR OFFICE FROM WHICH THE STATEMENT OF REASONS CAN BE OBTAINED) WITHIN 60 DAYS FROM THE DATE YOU ARE NOTIFIED OF OUR DECISION. WE WILL SEND YOU A WRITTEN STATEMENT OF REASONS FOR THE DENIAL WITHIN 30 DAYS OF RECEIVING YOUR REQUEST FOR THE STATEMENT.

ECOA Notices

• Adverse Action
  – Includes
    • Refusal to extend credit
    • Termination of account
    • Denial of increase in credit line
  – Does not include
    • Change in terms agreed to by Applicant
    • Forbearance/action in response to default/delinquency/inactivity
ECOA: Notification Obligations re: Adverse Actions

- Trade Credit – financing arrangement involving a buyer and seller, such as a supplier who finances the sale of equipment, supplies, or inventory
- Business Credit – extensions of credit primarily for business or commercial (including agricultural) purposes, subject to certain exclusions

ECOA: Notification Obligations re: Adverse Actions

- Differing Notification Obligations Depending on Whether Dealing With
  - Trade Credit Applicant, and Business Credit Applicant With Gross Revenues of More Than $1 Million
  - Business Credit Applicant with Gross Revenues of $1 Million or Less
### ECOA: Notification Obligations re: Adverse Actions

- **Notification Obligations Less Onerous For Trade Credit Applicant and Business Credit Applicant With More Than $1 Million of Gross Revenues**
  - Must notify applicant of adverse action orally or in writing within reasonable time
  - Must provide written statement of reasons for adverse action and ECOA notice if applicant makes written request for reasons within 60 days of notification

<table>
<thead>
<tr>
<th>ECOA: Notification Obligations re: Adverse Actions</th>
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<tbody>
<tr>
<td>Business Credit Applicant with Gross Revenues of $1 Million or Less</td>
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<tr>
<td>Creditor must notify applicant of any action taken on credit application within 30 days of receiving completed application</td>
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<tr>
<td>Creditor must provide applicant with oral or written statement of any adverse action</td>
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<tr>
<td>Creditor must advise applicant of applicant's right to statement of reasons for adverse action</td>
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<tr>
<td>In credit application</td>
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<tr>
<td>In communication of adverse action</td>
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<tr>
<td>Creditor must notify applicant within 30 days of taking adverse action on an incomplete application</td>
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### ECOA: Notification Obligations re: Adverse Actions

- Business Credit Applicant with Gross Revenues of $1 Million or Less (continued)
  - Creditor must notify applicant within 30 days of taking adverse action on an existing account
  - Creditor must notify applicant within 90 days of a counteroffer if the applicant does not expressly accept or use the credit offered

### Examples Of Reasons For Adverse Action

- Incomplete credit application
- Insufficient number of credit references provided
- Unacceptable type of credit references provided
- Limited credit experience
- Unable to verify credit references
- Income insufficient for amount of credit requested
- Excessive obligations in relation to income
- Poor credit performance with seller
- Delinquent past or present credit obligations with others
Examples Of Reasons For Adverse Action

- Garnishment, attachment, foreclosure, collection action or judgment
- Bankruptcy
- Number of recent inquiries on credit bureau report
- Value or type of collateral not sufficient
- Lack of established earnings record
- Slow or past due in trade or loan payments
- Other

Examples Of Improper Reasons For Adverse Action

- Action Taken Based on Creditor’s Internal Standards
- Debtor Failed to Obtain Minimum Qualifying Score on Creditor’s Scoring System
- Poor Credit Risk
- Financial Deadbeat
Fair Credit Reporting Act ("FCRA")

- Regulates Issuers of "Consumer Credit Reports" on Individuals
- Establishes Criteria for Business Entities to Obtain and Use Consumer Credit Reports on Individuals
- A Business Credit Grantor Can Obtain A Consumer Credit Report on An Individual Affiliated with Customer As Part of Credit Extension/Renewal for a "Permissible Purpose"

Fair Credit Reporting Act

- Federal Trade Commission – Staff Commentary
  - Extension of Trade Credit Not A Permissible Purpose
    - "Trade Credit": "generally limited to financing arrangement that involves a buyer and seller – such as supplier who finances the sale of equipment, supplies or inventory."
  - Individual's Acceptance of Personal Liability for Business Debt is Permissible Purpose
    - Sole Proprietor
    - General Partner
    - Guarantor
Fair Credit Reporting Act

• If No Permissible Purpose, Need Individual’s Executed Written Authorization to Obtain/Use Consumer Credit Reports Dealing With Individual

• Failure to Obtain Individual’s Authorization Could Expose Creditor to Liability for Violating FCRA, Including Criminal Penalties

Suggested Authorization Language:

“The undersigned individual, who is a principal of the credit applicant, recognizing that his or her individual credit history may be a factor in the evaluation of the credit history of the applicant, hereby consents to and authorizes the use of a consumer credit report on the undersigned by the above named business credit grantor, from time to time as may be needed, in the credit evaluation process.”
Adverse Action Based on Consumer Credit Report

Per FCRA, A Creditor Taking Adverse Action Based on Information In a Consumer Credit Report Must Provide Notice to the Consumer Containing the Following Information:

- Name, address and phone number of Consumer Reporting Agency that supplied the report
- Statement that Consumer Reporting Agency did not make the adverse decision and cannot explain why decision was made
- Notice of consumer’s right to free copy of their report if requested within 60 days
- Notice of consumer’s right to dispute the accuracy or completeness of the information in the report
- The consumer’s credit score, if a credit score was used

Adverse Action Based on Credit Score

As a Result of the Dodd-Frank Act, On July 6, 2011, the Federal Reserve Board and Federal Trade Commission Issued a Final Rule Requiring Creditors To Provide the Following Additional Information in Adverse Action Notices if a Credit Score is Used In Making a Credit Decision:

- Numerical credit score used;
- Range of possible scores under the model used;
- Key factors that adversely affected the credit score;
- Date on which the score was credited; and
- Name of the person or entity that provided the score.
Credit Score

• “A Numerical Value or Categorization Derived From a Statistical Tool or Modeling System Used By a Person Who Makes or Arranges a Loan to Predict the Likelihood of Certain Credit Behaviors, Including Default”
  – Could be obtained from consumer reporting agency

Proprietary Credit Scores

• Some Creditors Develop Their Own “Proprietary Scores” That May Be Based on Information Other than Information in a Consumer Credit Report
  – If a proprietary credit score is based on one or more factors other than those obtained from a consumer reporting agency, the score is not considered a credit score subject to disclosure
    • However, a creditor must disclose the reasons the consumer scored worse than other applicants
  – If a proprietary credit score is based on information contained in a consumer credit report, it is subject to disclosure per the rules applicable to a credit score
Guaranty – Spousal Guarantees Limits

• Spousal Guarantees – ECOA Regulation B Limits
• General Rule: Cannot Request Spousal Guaranty
• Spousal Guaranty Allowed in Following Circumstances:
  – Spouse can voluntarily offer guaranty
  – Spouse officer/principal
  – Joint principal-spouse ownership of property
  – Community property state
    • Principal/spouse reside there
    • Reliance on jointly owned property located there
    • Instrument must be necessary to make community property available to satisfy debt

Guaranty

• Division among U.S. Courts of Appeal on Validity of Regulation B’s limits on spousal guarantees
  – 8th Circuit – No
  – 6th Circuit – Yes
  – U.S. Supreme Court in split 4-4 vote affirmed 8th Circuit decision rejecting Regulation B’s limit on spousal guarantees

• This Issue will not be Resolved Until the Supreme Court again takes up issue
  – Lack of majority opinion means affirmance is not nationwide precedent and leaves state of the law in flux
PROPER USE OF SOCIAL MEDIA
Social Media

• WHAT IS IT?
  – Microblogging sites – e.g.,
    • Facebook
    • Google
    • Myspace
    • Twitter
  – Forums, blogs, customer review websites and bulletin boards – e.g.,
    • Yelp
  – Photo and Video sites – e.g.,
    • Flicker
    • YouTube
  – Sites that enable professional networking
    • Linked In
  – Virtual words
  – Social games

Recommendations

• Use of Social Media Must Be Carefully Managed
  – Does your company have a social media policy?
  – Has your company implemented appropriate procedures, training and oversight to ensure compliance with its social media policy and applicable laws?
THE SMOKING GUN IN YOUR
FILE THAT SINKS ORDINARY
COURSE OF BUSINESS
PREFERENCE DEFENSE
Preference: Elements Of Claim

• Any Transfer of an Interest of the Debtor in Property;
• To or for the Benefit of a Creditor;
• For or on Account of an Antecedent Debt Owed by the Debtor Before Such Transfer Was Made;
• Made While the Debtor was Insolvent;

Preference: Elements Of Claim (cont’d)

• Made:
  – On or within 90 days before bankruptcy filing; or
  – Between 90 days and one year before bankruptcy filing for transfers to insider creditors; and
• That Enables Such Creditor to Receive More Than Such Creditor Would Receive if:
  – The case were a Chapter 7 case
  – The transfer had not been made
  – Such creditor received payment to the extent provided by other provisions of Title 11
Preference Defenses

• Contemporaneous Exchange for New Value
  – Transfer was intended by debtor and creditor to be contemporaneous exchange for new value; and
  – Transfer was substantially contemporaneous exchange

• New Value
  – Creditor extending credit to debtor after payment, that was not secured and not paid by otherwise unavoidable transfer

Ordinary Course Of Business

• Transfer Was in Payment of a Debt Incurred by the Debtor in the Ordinary Course of Business or Financial Affairs of the Debtor and the Creditor; and

• Subjective Test – Made in the Ordinary Course of Business or Financial Affairs of the Debtor and the Creditor; OR

• Objective Test – Made According to Ordinary Business Terms

• Creditor Can Choose Most Beneficial (Subjective or Objective Test) Prong of Ordinary Course of Business Defense

• Very Fact Based
Ordinary Course Of Business

Range of Views
- How long of a payment history?
  - 1 Year?
  - 2 Years? U.S. Bankruptcy Court, Southern District, New York decision: Quebecor World
  - Longer?
- Range of payments
  - All payments? [American Home Mortgage Bankruptcy Court decision in Delaware]
  - Modified range? [Philadelphia Newspapers Bankruptcy Court decision in Eastern District, Pennsylvania]
  - Payments only when Debtor is healthy? [Circuit City Bankruptcy Court decision in Eastern District, Virginia]

Range of Views – cont’d
- Comparison of average days to pay/days late prior to and during preference period
  - Archway Cookies Bankruptcy and District Court decisions in Delaware –
    - Payments subject to subjective ordinary course defense, notwithstanding approximately 5 day difference in average days to payment during historical period (42.3 days) compared to preference period (47.2 days)
  - Quebecor World – Payments not subject to the subjective ordinary course defense where average days outstanding of 27.56 days prior to preference period vs. average days outstanding of 57.16 days during preference period
- Bucket analysis – examining payments by grouping – accepted – Quebecor World, U.S. Bankruptcy Court, Southern District of New York
Subjective Ordinary Course Of Business Preference Defense – Smoking Guns

- Change in the form of payment during preference period (regular check to wire)
- Change in method of invoicing (electronic to paper)
- Change in credit terms
- Imposition of credit limit/enforcement of existing credit limit
- Threats to stop shipment
- Change in mode of delivery (regular mail to Federal Express)

Smoking Guns In Vendor’s/Debtor’s File

- Vendor – “Based on future looking 12 month sales/dcm we need to move your credit limit down to $10.5M effective next week.”
- Vendor – “As a reminder, we will be enforcing the new LOC $10.5M starting this week. Please insure we revise our weekly spreadsheet accordingly.”
- Debtor – “I am also aware that Vendor will be reaching out to Debtor next week to discuss new restrictions on the credit line heading into the holidays.”
Smoking Guns In Vendor’s/Debtor’s File

- Vendor – “As I mentioned on the call, we already offer a prompt pay discount. We are willing to offer an additional discount of $50k on the $9 million of paydowns required to go from your current credit limit to the $2m limit. Administratively we will issue a credit to cover this at the end of December. I think this is cleaner than creating a situation where invoice amounts are altered.

- Vendor – “Thanks again for your time this afternoon. As mentioned, our plan is to limit our exposure to $2m by mid-December. In order to do this, the following paydown calendar must be used:"

<table>
<thead>
<tr>
<th>Date</th>
<th>Credit Limit</th>
<th>Add'l Paydown</th>
</tr>
</thead>
<tbody>
<tr>
<td>17-Nov</td>
<td>9</td>
<td>2</td>
</tr>
<tr>
<td>24-Nov</td>
<td>7</td>
<td>2</td>
</tr>
<tr>
<td>1-Dec</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td>8-Dec</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>15-Dec</td>
<td>2</td>
<td>1</td>
</tr>
</tbody>
</table>

Smoking Guns in Vendor’s/Debtor’s File

- Debtor – “We can’t allow these guys to bully us – we need to offer our proposal to get them to 6-7 mm by xmas – 2mm by mid Dec is a joke.”

- Debtor – “I just got off the phone with [Vendor], and reiterated our disappointment and surprise at the size of their credit contraction. I stressed to him that we were not experiencing similar pressures from our other vendors, and that we were optimistic about our chances of procuring additional financing if our holiday expectations were not met. Therefore – and in light of our $2M good faith payment made last week – I asked for a reconsideration of this decision.”

- Debtor – “I just got a call from [Vendor], who is now threatening shipment cut-off if he doesn’t see his wire payment this morning. Let me know if you want to release the wire this morning.”
Smoking Guns in Vendor’s/Debtor’s File

- Vendor – “Please find attached all invoices that are due for payment from [Customer]. They are all past or nearly past 60 days. I believe you were to make payment a few days ago which we are yet to receive. Please can you tell me the status of the payment and when we shall be receiving it. Unfortunately until the invoices are paid the [Customer] account will be put on a temporary stop.”

- Vendor – “We will need to speak to our attorney before negotiating further the terms of the forbearance agreement...but we must have another $500K wire transferred by 3PM today to keep the services on.”
- Debtor – “No problem. I will have the $500K wired today.”
- Vendor – “Have left you a couple of voicemails. The payment due on Wednesday was not made. Our current exposure to you is over $10m, even though we have a stated credit limit of $3m. We are in a position now where orders will not be shipped if the payment due is not made this morning.”
Smoking Guns in Vendor’s/Debtor’s File

- Vendor – “We need to incorporate changes into your weekly processes starting next week: daily balances can’t go above the established credit limit ($3M). I would recommend Mon and Wed wires”

- Debtor – “Please provide confirmation and amount of the required wire this morning as soon as possible. I’ll contact you later to discuss how we’ll need to revamp our weekly payment process.”

Smoking Guns in Vendor’s/Debtor’s File

- Vendor CFO – “This shipment cannot go out until we approve as we do not have available credit line to cover this at this time. We are following with Debtor for check in transit information.”

- Vendor – “Right now we have $1,209K available since we are allowed a 10% override waiting for #’s. If we can confirm the $1.3M was sent overnight on Friday, we can release another $1.3M against that as well.”
Smoking Guns in Vendor’s/Debtor’s File

- Vendor – “Subject: Orders on Credit Hold -- Have you let them know that [Debtor] is essentially on credit hold until they call back? I have this sick feeling that no one above the directors on their side realizes that shipments have stopped…”
- Vendor – “Subject: Credit Line Hold? - Do we still have product on credit hold? If so, what is the current situation with orders on hold and can we release anything?”
- Vendor – “Can we release the balance of the credit hold based on this new check?”

Smoking Guns in Vendor’s/Debtor’s File

- Vendor – “We need a list of products that are on credit hold... I need to work with the [Customer’s] buyers to determine what to release ASAP.”
- Vendor – “Nothing currently in credit hold can be released. We need to prioritize which ones should be released first once we have approval to increase exposure.”
QUESTIONS?

Speaker Contact Information

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