

Financial Services UPDATE



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Storm Warning!

By Jeffrey A. Wurst

Imagine you turn on your television set to watch the news and you see that your favorite weather report is warning viewers that a severe hurricane is headed in your direction. You walk outside and see a perfectly clear sky, enjoy the rays of the sun and cannot see a cloud anywhere in the sky. What do you do? Do you prepare your house for a hurricane and put away the lawn furniture, tie down loose objects, secure the windows? Do you ignore the warning because what you see is contrary to the forecast?

The question may seem silly, but how do you deal with forecasts affecting your business?

Let's start with what everybody knows about the current economy:

- ▶ Interest rates are the lowest in recent memory.
- ▶ Business borrowing is at the highest level in recorded history.

New Foreclosure Procedures Under Revised Article 9

By Karen J. DeSalvo

Former Article 9 of the Uniform Commercial Code (Article 9) gave lenders limited guidance when foreclosing on a borrower's assets following default. Revised Article 9 (RA9) attempts to clarify the lender's rights and responsibilities when foreclosing its lien on the borrower's assets following default. In some instances, RA9 sets forth specific procedures that must be followed by the lender when liquidating collateral.

Under RA9, after a default, a lender has the right to seize its collateral without judicial process, provided that engaging in self-help will not be a *breach of the peace*. As a practical matter, the lender will not be able to foreclose on collateral in the borrower's possession without the borrower's consent or a court order.

Following an event of default, a lender under Article 9 could sell, lease or otherwise dispose of any collateral in which it had a security interest. In addition, under RA9, a lender may now



- ▶ The stock market has been depressed for two years—this is the primary reason why the Fed has reduced interest rates.

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license the collateral. The lender may, at its option, dispose of the collateral in its present condition or following any commercially reasonable preparation or processing. The lender should evaluate the potential benefits that would result from the preparation or processing of the collateral prior to disposing of it. RA9 continues to allow the lender great leeway in disposing of the collateral, so long as every aspect of the sale is conducted in a *commercially reasonable* manner. This duty of the lender cannot be waived or varied, though the parties may define *commercially reasonable* by contract (so long as the standards agreed upon are not man-



Karen J. DeSalvo

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Message From The Chair

Creative Thinking Helps Our Clients



Jeffrey A. Wurst

We have been busy working to help our clients who are facing rocky financial times.

- ▶ We are presently representing the debtor in the largest Chapter 11 bankruptcy case pending in the Eastern District of New York—with some 70,000 creditors.
- ▶ We recently concluded a workout on behalf of a Long Island manufacturer and distributor of electronic equipment, saving them \$11 million. We performed

an out of bankruptcy reorganization by negotiating concessions from unsecured creditors and the bank lenders to attract a new lender. In the end, we obtained \$9 million in reduction in payables – mostly by exchanging debt for stock, and the balance by a cash payment of ten cents on the dollar. The bank lenders ultimately agreed to a \$2 million discount enabling an asset based lender to make a loan to a restructured vital company. The company is now thriving.

- ▶ We represented an underwriter that agreed to fund a plan of reorganization for an Oklahoma public company emerging from Chapter 11. The company's original plan envisioned a distribution of stock to unsecured creditors in exchange for their claims, to be funded by a private placement underwritten by our client. However, we showed our client that a public offering would be a better move than a private placement.

We knew that distribution of stock under a plan of reorganization in exchange for claims is exempt from registration—and, thus, fully tradable. However, stock to be issued to new investors in a raise up was not addressed in the Bankruptcy Code.

We amended the company's reorganization plan to issue stock—exempt from registration—to the new investors, and we obtained an order from the Bankruptcy Court authorizing such issuance.

- ▶ We are presently investigating funding a plan of reorganization by an initial public offering (IPO) exempt from registration. We will keep you posted as that develops.

In addition to these extraordinary matters, we remain active with our bread and butter matters: loan documentation, workouts, DIP financings, defense of preference and fraudulent conveyance actions, and acquisitions of distressed assets and entities through the bankruptcy process. Please feel free to call us to assist you with these and other financially related matters. ■

Storm Warning!

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Now let's look at how the dominos start to fall.

At some point, the stock market will rebound. When it does, interest rates will rise as well—probably very quickly. At that time, businesses that had enjoyed cheap money will find themselves trying to meet debt service nearly double to what they had become accustomed—assuming a raise of the unreasonably low prime rate of 4.75 to a more reasonable 8.5.

What next? You guessed it—a flood of defaulted loans, bankruptcies, bank write-offs, etc.

How to Avoid The Storm of Financial Insecurity

- ▶ **Start planning now.** Work down your bank lines. Start to sell off slow or obsolete inventory and equipment to assist in this effort.
- ▶ **Monitor your customers' credit ratings.** Don't get caught with an abundance of slow, or worse, uncollectible receivables that will, in turn, have an impact on your company's financial stability.
- ▶ **Reevaluate your staffing needs.** Terminate surplus and underproductive staff (after reasonable efforts to make them productive, of course).
- ▶ **Revisit the equity markets.** While interest rates are low, equity rates are expensive. When interest rates rebound —comparatively, equity will be less costly.

Despite the notorious bankruptcy cases of the past few years, there have been relatively few middle market bankruptcies. This will not last. In each recession, the middle market bankruptcies did not hit until after the stock market showed signs of recovery. History tends to repeat itself.

This is the time to closely examine your business to see where it is vulnerable. In our experience, most business failures occur because the principals fail to heed warnings and act too late. Remember that the best way to solve a problem is to avoid it—not ignore it. ■

Jeff Wurst chairs the Financial Services Department. He can be reached at 516-663-6535 or jwurst@rmfpcc.com.

What Every Lender to the Health Industry Needs to Know About HIPAA

By Keshia Thompson



Keshia Thompson

Lenders and factors to the health care industry are advised to familiarize themselves with the Health Insurance Portability and Accountability Act ("HIPAA"). Certain regulations under HIPAA (which impact health care lenders and factors) require compliance by **April 14, 2003**.

HIPAA requires health care providers that electronically transmit or receive health information (i.e., hospitals, nursing homes, physician practices, medical billing companies, home health care providers) use standardized codes when conducting specific transactions after October 16, 2002.

Individuals and entities that perform services involving the use of individual patient health information are considered **business associates**. Business associates must adhere to certain privacy standards or jeopardize the provider's HIPAA compliant status.

Lenders that receive protected patient health information will likely be deemed business associates.

Providers must have written agreements requiring business associates to maintain the confidentiality of protected patient health information. These agreements may provide indemnities to providers for penalties as a result of a business associates' failure to comply with HIPAA.

Providers that fail to comply with HIPAA – including the failure to keep its business associates in compliance – may be subjected to civil penalties of up to \$25,000 and misdemeanor or felony penalties for wrongfully and knowingly disclosing protected patient health information.

Providers must comply with HIPAA privacy regulations by April 14, 2003. For more information about HIPAA and compliance regulations, please feel free to contact us. ■

Keshia Thompson is a member of the firm's HIPAA Compliance Group. She can be reached at 516-663-6635 or kthompson@rmfpc.com.

New Foreclosure Procedures Under Revised Article 9

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ifestly unreasonable). What constitutes commercially reasonable is fact sensitive and requires analysis and experience. The lender may still purchase collateral at a public disposition or a private disposition if the collateral is of the kind that is customarily sold on a recognized market or has widely distributed standard price quotations.

However, lenders and borrowers should be aware of one substantial change involving the disposition of collateral. Unless expressly disclaimed, lenders who voluntarily dispose of collateral provide the purchaser with warranties relating to title, possession and quiet enjoyment, as a matter of law. For example, if the collateral the lender is disposing of consists of goods, the lender provides the purchaser with warranties of title, merchantability and possibly also of fitness for a particular purpose.

If the collateral to be sold is not consumer goods, before proceeding with a foreclosure sale, the lender is required to give notice to: (1) any person that the lender has received an authenticated notice from claiming an interest in the collateral; (2) any other secured party or lien holder who ten days before the notification date had properly perfected its interest via a financing statement; and (3) any other secured party who ten days prior to the notification date held a security interest perfected by compliance with any statute, regulation or treaty described in RA9.

The lender's notification of a foreclosure sale must be a reasonable, *authenticated record*, transmitted either in writing or electronically or by any other medium that is retrievable in

perceivable form. However, notice is not required if the collateral is perishable, threatens to decline quickly in value, or is customarily sold on a recognized market. In addition, RA9 provides the foreclosing lender with a *safe harbor* in non-consumer transactions if the notice is sent at least ten (10) days prior to the sale. The parties may provide by agreement the standards by which the lender's fulfillment of its duties is to be measured, so long as the standards selected are not *manifestly unreasonable*. After default, the borrower, under RA9, may waive its right to notice of a foreclosure sale by an authenticated agreement.

For non-consumer goods transactions, a lender's notice will be deemed sufficient under RA9 if it: (1) describes the borrower and the lender; (2) describes the collateral that is the subject of the intended disposition; (3) states the method of the intended disposition; (4) states that the borrower is entitled to an accounting of the unpaid indebtedness and states the charge, if any, for such an accounting; and (5) states the time and place of the public sale or the time after which the lender may sell the collateral at a private sale. For convenience, RA9 provides a sample form of notice that, if complied with, would satisfy the reasonable notification requirement.

Although foreclosure under RA9 is very similar to foreclosure under Article 9, the procedures set forth in RA9 must be strictly adhered to in order to minimize risk to the lender liquidating the collateral. ■

Financial Services, Banking & Bankruptcy

- Commercial Loan Transactions
- Asset-based Loan Transactions
- Distressed Asset Management
- Loan Workouts and Bankruptcy
- Intercreditor, Subordination, Co-Factoring and Re-Factoring Agreements
- Debtor-in-Possession Financing
- Actions for Goods Sold and Delivered
- Actions on Guarantees
- Actions to Recover Personal and Real Property
- Preference Actions Litigation
- Defense of Lenders Against Equitable Subordination, Fraudulent Conveyance and RICO Claims
- Intercreditor Dispute Litigation
- Bank Regulatory and Compliance Matters



ABOUT THE FIRM

Founded in 1968, Ruskin Moscou Faltischek, P.C. is one of Long Island's largest law firms, with a staff of 120 people — including more than 60 professionals. The firm's legal practice groups have substantial experience in the areas of mergers and acquisitions, securities offerings, technology, Internet, intellectual property, trademarks and copyrights, trial and appellate litigation, health law, seniors' housing, municipal and regulatory affairs, energy matters, commercial lending, real estate, employment, distressed asset management, loan workouts and bankruptcy, banking regulations, construction, environmental matters, Surrogate Court litigation, wills, trusts and estate planning, white collar crime and investigations, business succession planning and international business transactions. Ruskin Moscou maintains offices on Long Island and in New York City.

The *Financial Services Update* is published for the purpose of providing clients, colleagues and friends of Ruskin Moscou Faltischek, P.C. with information about developments in financial services matters. It is not a substitute for legal advice and should not be construed as imparting legal advice generally or on specific matters.

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