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Update
LITIGATION

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The contents of this newsletter are for informational purposes only and do not constitute legal advice. For guidance regarding a specific fact situation, you are urged to contact one of the firm's attorneys.

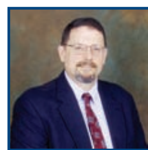
Sterns & Weinroth Supports the Local Community

Joel H. Sterns and Richard K. Weinroth founded Sterns & Weinroth in 1969, with the idea of offering quality legal services, providing personalized attention, and supporting the local community. After 40 years, the Firm continues to draw on the diversity and unique talents of its lawyers, paralegals and support personnel to provide legal services to a broad range of significant clients, and it never forgets its community responsibilities.

This holiday season, for the 13th year, Sterns & Weinroth attorneys, staff and friends served as "Santa" to brighten the holidays for some of the area's underprivileged children through the CLAUS (Children Loved by Another Understanding Santa) Project. The Project, coordinated by Mercer County Social Services, was founded in 1991 and assists in fulfilling the wishes of hundreds of Mercer County children who may not otherwise receive holiday gifts. The Program requests gift donations that are provided to the children's parents, to allow them to serve as Santa Claus. Sterns & Weinroth, together with Langan Engineering & Environmental Services of Trenton, NJ, provided gifts to over 60 children. The Firm also collected and delivered 15 bags of non-perishable goods and hygiene products to the Trenton Area Soup Kitchen (TASK) during this year's Holiday Collection Drive.

Throughout the year, individuals and the Firm continue to support others in need. Several times throughout the year, the Firm's attorneys, employees, friends and family donated their time by baking brownies and cookies, making peanut butter and jelly sandwiches and packing over 400 brown bagged lunches that were delivered to TASK. These donations help to provide an extra meal to those in need.

As we enter the new year, with uncertain economic conditions, our commitment to supporting the local community will become even more important. Sterns & Weinroth encourages all employees to participate in the Firm's support of our local community and the individual efforts to support local and national charities. ■



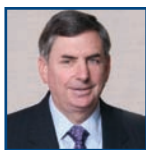
Contractors and Architects Protection After Ten Years From Completion of Services

By: Edgar Alden Dunham, IV

The Statute of Repose, N.J.S.A. 2A:14-1.1(a), provides that an action for deficient design or construction may not be brought "more than 10 years after the performance or furnishing of such services and construction."

In Daidone v. Buterick Bulkheading, et al. 191 N.J. 557, the New Jersey Supreme Court disagreed with a plaintiff's interpretation of the statute that would have commenced the running of the ten year period on the issuance of a certificate of occupancy. In Daidone, the plaintiff was a homeowner that acted as his own general contractor. Plaintiff brought an action against certain contractors and the architect more than 10 years after the work was performed, but less than 10 years after the certificate of occupancy was granted. The plaintiff argued that New Jersey's public policy favoring the protection of homeowners and consumers required the adoption of a uniform indisputable date from which the Statute of Repose should run for all aspects of a construction project. Plaintiff suggested that to do otherwise would place an unfair burden on the owner since the statute would begin to run at different times depending upon when the various affected persons (contractors, subcontractors, architects, etc.) completed their work.

The Supreme Court was not persuaded and held that the plain language of the statute was clear. The cause of action "ceases to exist ten years and one day after the designer or contractor has performed or furnished his or her design or construction services." For more information, please contact Edgar Alden Dunham, IV at 609-989-5021, or edunham@sternslaw.com. ■



Charitable Immunity Amended, But Still a Viable Defense

By: Michael A. Spero, Esq.

Originating in nineteenth century Britain, charitable immunity insulates a charitable organization from tort liability. The basis for the doctrine was the belief that charitable funds should not be diverted from the purpose for which they were donated. New Jersey followed the doctrine until 1958 when in two cases the New Jersey Supreme Court abolished it. Quickly after the Supreme Court decisions, the Legislature restored it with temporary legislation and then in 1959 adopted the Charitable Immunity Act, the purpose of which was to reinstate the common law doctrine.

The New Jersey Charitable Immunity Act, N.J.S.A. 2A:53A-7 *et seq*. bars negligence claims against a non-profit corporation organized exclusively for religious, charitable, educational or hospital purposes. In pertinent part, the statute provides that:

No non-profit corporation, society or association organized exclusively for religious, charitable or educational purposes or its trustees, directors, officers, employees, agents, servants or volunteers shall, except as is hereinafter set forth, be liable to respond in damages to any person who shall suffer damages from the negligence of any agent or servant of such corporation, society, or association, where such person is a beneficiary, to whatever degree, of the works of such non-profit corporation, society or association; provided, however, that such immunity from liability shall not extend to any person who shall suffer damage from the negligence of such corporation, society, or association or of its agents or servants where such person is one unconcerned in and unrelated to and outside of the benefactions of such corporations, society or association.

The immunity provided to a qualified organization extends to those who may be employed by the organization or served without compensation such as trustees, directors, officers, employees, agents, servants and volunteers. The Act does expressly exclude from immunity any health care provider in the practice of his or her profession who is a compensated employee, agent or servant of any non-profit corporation, society or association organized exclusively for religious, charitable or educational purposes. Similarly, independent contractors of a protected organization are not granted immunity. Often, a non-profit's organizational documents or certificate of incorporation establish their religious, charitable, educational or hospital purposes, as does exemption from federal income tax and state sales and use taxes.

For a protected organization to prevail in an action brought against it by a plaintiff, the organization must show that it meets the statutory requirements for charitable immunity. This requires a showing that the non-profit is organized either exclusively for either religious, charitable or educational purposes. New Jersey state and federal courts have afforded statutory immunity numerous times to the status of universities. For example, in Lax v. Princeton University, 343 N.J. Super. 568 (App.Div. 2001), the court stated, without analysis, that Princeton University was a non-profit corporation devoted to educational purposes. Lax dismissed, on charitable immunity grounds, a negligence suit against the University based upon plaintiff's fall in Richardson Auditorium, a University building, while attending a Princeton Chamber Symphony, (a charitable entity independent of Princeton University).

While the Act does not bar a claim of "one unconcerned in and unrelated to and outside of the benefactions of such corporation, society or association…" the protected organization must show that the plaintiff was a beneficiary "to whatever degree" of the works of the organization. As an example, in the previously mentioned Lax case, members of the general public are beneficiaries of Princeton University's promotion of its educational works. Lax involved a member of the public who was on University property when she allegedly tripped and fell. She was a resident of a retirement community attending a classical music concert for which she had purchased a subscription. The concert was sponsored by the Princeton Chamber Symphony, which rented the University's Richardson Auditorium.

Members of the general public touring property owned by a charitable organization are beneficiaries of that organization's charitable works. In Bieker v. Community House of Moorestown, 169 N.J. 167 (2001), the New Jersey Supreme Court dismissed a lawsuit brought by the parents of a three year old boy who was injured when he fell off of a fire escape in defendant's community center/gymnasium, while his father played basketball. The court found that the child was "plainly a recipient of an [defendant] Community House's 'benefactions' even if only as a companion of his father and a spectator at his father's basketball game." In Anasiewicz v. Sacred Heart Church, 74 N.J. Super 532 (App.Div.) certif. den., 38 N.J. 305 (1962) a non-church member/wedding attendee's personal injury suit against the church as a result of a slip and fall on icy outside steps was

Photo by Mahlon Lovett/Office of Communications, Princeton University.

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Wizards, Witches and Copyright Law: Harry Potter and the Fair Use Doctrine

By: Jonathan H. Katz Esq.

If you have read J.K. Rowling's series of seven novels chronicling the adventures of Harry Potter (or have seen the movies based on these stories), you can no doubt appreciate the vividness of the magical world that Rowling has created. Not unlike the "hobbits" and "elves" in Tolkien's Lord of the Rings, Rowling's tales of wizards and witches introduce the reader to such imaginative terms as "muggles", "quidditch" and, of course, "Lord Voldemort". So it came as no surprise that someone would create a reference guide to catalogue these new and unusual terms. What was a surprise was the legal battle that followed – a battle that concluded this past year and made its mark on copyright law and the fair use doctrine.

In his decision to block this proposed reference guide – dubbed the Harry Potter Lexicon – U.S. District Court Judge Robert P. Patterson, Jr. held in Rowling v. RDR Books that the "reference guide to the popular Harry Potter book series appropriated too much of author J.K. Rowling's creative work for its purposes", and, further, that defendant's use of Rowling's work did not constitute a fair use in this case.

But we're getting ahead of ourselves. Like any good story, in order to properly understand how we reached this conclusion, we must begin at the beginning…

Following the initial success of the Harry Potter books, Steve Vander Ark, a librarian from Michigan, created the non-profit "Harry Potter Lexicon", an internet-based encyclopedia where contributors collected information about the people, places and things that inhabited the Harry Potter universe and organized them into a searchable form. Over time, the online Lexicon grew into what is widely regarded as the most complete and authoritative reference guide to the world of Harry Potter, attracting upwards of 25 million web-visitors per year.

In August of 2007, Vander Ark was contacted by RDR Books, who enticed him to agree to let RDR publish a for-profit print version of the Lexicon. However, prior to publication, on October 31, 2007, Ms. Rowling and Warner Brothers filed suit against RDR, alleging that RDR's attempt to publish a print version of the Lexicon infringed upon their copyright. Specifically, their complaint alleged that the proposed Lexicon "compiles and repackages Ms. Rowling's fictional facts derived wholesale from the Harry Potter works without adding any new creativity, commentary, insight, or criticism". RDR countered that Ms. Rowling "appears to claim a monopoly on the right to publish literary reference guides, and other non-academic research, relating to her own fiction… This is a right no court has ever recognized [and] if accepted, it would dramatically extend the reach of copyright protection, and eliminate an entire genre of literary supplements."

Following three days of testimony from April 14–17, 2008, on September 8, 2008, Judge Patterson ruled in Ms. Rowling's favor, determining that "[p]laintiffs have shown that the Lexicon copies a sufficient quality of the Harry Potter series to support a finding of substantial similarity between the Lexicon and Rowling's novels." Of particular importance, the Court found that the Lexicon's entries "often [made] it difficult to know which words are Rowling's and which are Vander Ark's." Thus, Judge Patterson held that RDR had infringed upon Rowling's copyright, having shown that the Lexicon "draws its content from creative, original expression in the Harry Potter series and companion books".

However, even though infringement was clear in this case, RDR asserted the defense that the Lexicon was a "fair use" of the Harry Potter works. As set forth in the Copyright Act, 17 U.S.C. § 107:

> fair use of a copyrighted work … for purposes such as criticism, comment, news reporting, teaching … scholarship, or research, is not an infringement of copyright. In determining whether the use made of a work in any particular case is a fair use the factors to be considered shall include (1) the purpose and character of the use, including whether such use is of a commercial nature or is for nonprofit educational purposes; (2) the nature of the copyrighted work; (3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole, and (4) the effect of the use upon the potential market for or value of the copyrighted work.

Noting that the evaluation of these factors is "an open-ended and context-sensitive inquiry", Judge Patterson examined the Lexicon based on these four factors and determined that "the purpose of the Lexicon's use of the Harry Potter series is transformative", meaning that it "adds something new, with a further purpose or different character, altering the first with new expression, meaning or message." Yet, the Court ultimately determined that the "fair-use factors, weighed together in light of the purposes of copyright law, fail to support the defense of fair use in this case". Judge Patterson did add, however, that "[w]hile the Lexicon, in its current state, is not a fair use of the Harry Potter works, reference works that share the Lexicon's purpose of aiding readers of literature generally should be encouraged rather than stifled."

The importance of this precedent regarding the fair use doctrine has been viewed as a victory for both sides. In one respect, the decision validates an author's rights over the freedoms of secondary users of copyrighted works. However, equally important is the Court's finding that copyright holders cannot exert exclusive control over the market for reference works when such works are sufficiently transformative in nature.

Despite the adverse ruling, attorneys for RDR – a group of intellectual property lawyers from Stanford Law School's Fair Use Project – were not discouraged by the defeat. In a statement published on their website, the group stated that Judge Patterson "recognized that as a general matter authors do not have the right to stop publication of reference guides and companion books about literary works, and issued an important explanation of why reference guides are not derivative works." However, regarding the decision to permanently enjoin the publication of the Lexicon, the group continued that "[c]areful and thoughtful as the decision is, we think it's wrong. So stay tuned to see where we go from here."

For more information, please contact Jonathan H. Katz Esq., at (609) 989-5036 or jkatz@sternslaw.com. ■

Using a Passing Comment From a Supreme Court Case, An Appellate Court Shreds Lien Law

By: Edgar Alden Dunham, IV, Esq.

It has long been the law in New Jersey that subcontractors or other parties on construction projects without direct contracts with the owner, cannot bypass the requirement of privity of contract by suing owners for lack of payment on the basis of unjust enrichment, restitution, quasi-contract or similar doctrines such as quantum meruit. Insulation Contracting & Supply v. Kravco, Inc., 209 N.J. Super. 367 (App. Div. 1986).

Thus, the only avenue available to such parties that lack privity of contract has been through their lien rights under the Construction Lien Law, N.J.S.A. 2A:44A-1, et seq. on private construction projects, and the Municipal Mechanics Lien Law, N.J.S.A. 2A:44-125, et seq., on public construction projects. A subcontractor or someone else whose contract is with a subcontractor or prime contractor and not directly with the owner, has no remedy against the owner for lack of payment if he cannot meet the requirements of the lien laws. A subcontractor, in such situation only has recourse against the other party to the contract.

On March 23, 2004, the New Jersey Supreme Court decided Craft v. Stevenson Lumber Yard, 179 N.J. 56 (2004), an important case in the evolution of the Construction Lien Law. In Craft, a builder had gone out of business and failed to complete the plaintiff's home. The plaintiff paid the builder for all work performed and the builder paid the lumberyard for the materials used in the construction. However, the builder owed the lumberyard for other projects and did not specify that the payments to the lumberyard for plaintiff's project were to be allocated to the invoices for the supplies purchased for plaintiff's project. The lumberyard allocated the payments to the builder's earlier open invoices and sued the plaintiff under the Construction Lien Law.

The Supreme Court held that where payments are up to date when a contractor walks off the project over a homeowner's objection, there is no money remaining in the contract to pay subcontractors, and hence no liability to the owner. Although that holding alone decided the case, the Court also held that suppliers on construction projects, like the lumberyard, are obligated to allocate a builder's payments to the project for which the supplies were purchased. Because the lumberyard in Craft had not done so, the Court ruled that it had no entitlement to make the lien claim.

In reaching its decision, the Court found that nothing in the lien law precludes a lien claimant from pursuing other remedies it may have at law, relying upon Grosbeck v. Linden, 321 N.J. Super 349 (App. Div. 1999). The Court noted, "put another way, Stevenson, [the lumberyard], can exercise other means to recoup payments for the supplies it delivered to Aladich sites including suing Aladich [the builder], Craft [the plaintiff homeowner], and all other owners for the benefit of whose property it delivered supplies." The Court did not indicate precisely what other means the lumberyard might have against the homeowners, but was presumably referring to such legal doctrines as unjust enrichment, restitution, quasi-contract, or quantum meruit as those doctrines focus on the benefit received.

The Court's statement was consistent with existing case law when it noted that the lumberyard still had other legal remedies against the builder (contract claims for instance). It was, however, directly contrary to the holding of Insulation Contracting & Supply to the extent it indicated that the lumberyard had such remedies as unjust enrichment, restitution, quasi-contract or quantum meruit against the plaintiff homeowner and the other homeowners arising out of the benefit those persons had received as a result of the delivered supplies.

It is unlikely that the Supreme Court intended to overrule Insulation Contracting & Supply at the time; otherwise it would have presumably explicitly pointed out its intention to do so. Insulation Contracting & Supply is not mentioned anywhere in the opinion. It is doubtful the Court was at all focused upon it the time.

The Supreme Court's ruling in Craft, that suppliers like the lumberyard are obligated to allocate payments, was dictum, a statement not necessary to decide the case. The Court's ruling on the lien fund was sufficient to do that. However, because the allocation of payments issue was directly involved in the questions before the Court and was argued, the Court's clearly carefully considered ruling was judicial dictum and, while not binding, is entitled to great weight. The Court's comment regarding the lumberyard's ability to recoup its damages from the builder and the various owners, on the other hand, was simply an illustration of the Court's view of the applicable law at the time (albeit mistaken). Insulation Contracting & Supply was presumably not taken into account because the issues that it focuses on were not before the Court in Craft. Accordingly, the Court's comment regarding the lumberyard's remedies against the homeowners is obiter dictum, which is not entitled to great weight.

On August 26, 2008, on the basis of the Supreme Court's obiter dictum (an expressed opinion by the court) in Craft, the Appellate Division in an unpublished decision captioned A-Tech Concrete Co. v. West Orange Public Schools, R.W. Merkel, Inc., and Pike Construction Co., Docket No. A-1944-07T3, ruled that a sub-subcontractor that failed to perfect its lien rights, was nonetheless entitled to pursue a quantum meruit claim against a municipal owner under the Municipal Mechanics Lien Law. Again there is no mention of Insulation Contracting & Supply in the opinion, and according to counsel for one of the parties; it was never brought up during the case.

The decision by the court in A-Tech, is a radical departure from the applicable law set forth in Insulation Contracting & Supply. Typically, courts do not infer a radical departure from controlling precedent by the Supreme Court unless an unmistakable intention to do so has been articulated. State v. Hicks, 283 N.J. Super 301, 308 (App. Div. 1995).

If the Supreme Court in Craft had intended to overrule Insulation Contracting & Supply and permit quantum meruit claims to jump links in the contractual chain on a construction project, surely it would have explicitly said so. Additionally, there would have been some mention of it in Richard Pulaski Construction Co., Inc. v. A.R. Frame Hangers, Inc., 195 N.J. 457 (2008). There a contractor that built hangers for a tenant at a public airport

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Charitable Immunity amended, but still a viable defense *(continued from page 2)*

dismissed on charitable immunity grounds as was the plaintiff's case dismissed in Loder v. St. Thomas Greek Orthodox Church, 295 N.J. Super. 297 (App.Div. 1996). In Loder, the court dismissed on charitable immunity grounds, a personal injury suit brought by a non-church member/Greek festival attendee injured in a slip and fall on church grounds finding that the plaintiff was a beneficiary because he voluntarily partook in the church's efforts to introduce and educate the community about the importance of Hellenic culture.

While a claim by an individual unconcerned in and unrelated to an outsider of the benefactions of the institution are not within the immunity of the Act, neither are claims against a trustee, director, officer, employee, agent, servant or volunteer who has caused damage by a willful, wanton or grossly negligent act of commission or omission including the sexual assault or other crimes of a sexual nature. To be sure, following a case against the American Boychoir in Princeton, the Legislature amended the Act effective January 5, 2006 to exclude from the immunity from civil liability granted to a non-profit corporation, society or association organized exclusively for religious, charitable, educational and hospital purposes, any claim that the "negligent hiring, supervision or retention of any employee, agent or servant resulted in a sexual offense being committed against a person under the age of eighteen (18) who is a beneficiary of the non-profit organization."

Also, excluded from immunity are claims against any trustee, director, officer, employee, agent, servant or volunteer who has caused damage as a result of the negligent operation of a motor vehicle within the exercise of his or her duties.

A hospital that can demonstrate that it is a non-profit corporation, society, or association and is organized exclusively for hospital purposes also qualifies for protection under the Act. Trustees, directors, officers and volunteers may share in the immunity enjoyed by the qualified hospital institution if their service is without compensation. An agent, employee or servant of the institution is not afforded immunity.

The Act also caps the prospective liability of a non-profit hospital for damages as a result of the negligence of the institution or its agents or servants at $250,000 together with interest and costs of suit arising from any one accident. The cap is available only to organizations "organized exclusively for hospital purposes."

While the charitable immunity statute has withstood constitutional challenges and is "deemed to be remedial and shall be construed so as to afford immunity to the said corporations, societies and associations from liability as provided herein," it is still incumbent upon the organization to demonstrate that it satisfies the requirements of the statute. After litigation is commenced, it remains a question of law for a court to decide whether a non-profit corporation, society, or association is organized for religious, charitable, educational or hospital purposes where an application to the court reveals an absence of genuine material facts in dispute. Such motions frequently dispose of plaintiff's claims in advance of trial.

Although there was a tremendous amount of publicity generated by the American Boychoir case and many calls for the repeal of the Charitable Immunity Act, the Act was only amended as noted and it still remains as an affirmative defense to be raised by qualified organizations.

For more information, please contact Michael A. Spero at 609-989-5009, or mspero@sternslaw.com. ■

Using a Passing Comment ... An Appellate Court Shreds Lien Law *(continued from page 4)*

filed a defective construction lien claim. The case examined whether the contractor was entitled to a claim of prima facie tort against the officer and shareholder of the insolvent tenant. One would have expected a discussion as to whether the contractor was entitled to any sort of quantum meruit claim against the public entity that owned the airport and received the benefit of the hangers if the Court believed it had previously overruled Insulation Contracting & Supply. There was none.

The dictum relied upon by the A-Tech court was far from an unmistakable articulation of intent to overrule existing law. It was simply an example of obiter dictum offered as an illustration (albeit mistaken) as to what the Court believed the existing law was. As obiter dictum it is neither binding nor entitled to great weight. It should not have decided the case. Other recent Appellate Division decisions appear to have recognized this. Eastern Concrete Materials, Inc. v. Tarragon Edgewater Associates, LLC, et als, A-0067-07T3, approved for publication-September 16, 2008.

As an unpublished decision, A-Tech Concrete has no precedential value and it is not binding on any court. R. 1:36-3. However, particularly with the advent of the internet, unpublished decisions are frequently, and successfully, used to persuade courts. In this case, if parties are able to successfully use the Supreme Court's comment in Craft and the A-Tech Concrete decision to, in essence, overrule Insulation Contracting & Supply, the Lien Law will be eviscerated. No longer would there be any need for subcontractors or others lacking privity in the contractual chain on a construction project, to follow the strict requirements of the Lien Law in order to sue the owner. Owners, in particular, would be vulnerable to claims from parties that they weren't even aware worked on their project. Owners are presently protected from such claims by the provisions of the Lien Law. Indeed those provisions were part of the legislative compromise that resulted in the Construction Lien Law. It is a bad case for owners.

The A-Tech decision is one that will no doubt cause a great deal of mischief in the construction world. The municipal owner in the A-Tech case is considering an appeal to the Supreme Court on the basis of Insulation Contracting & Supply. Hopefully, the Supreme Court grants certifications and rules to protect the integrity of the Lien Law.

For more information about construction liens or other construction law related issues, please contact Edgar Alden Dunham, IV at 609-989-5021, or edunham@sternslaw.com. ■

Tax Appeal Basics

By February 1, all municipal tax assessors in New Jersey are required to provide property owners with a notice of the current year's assessment, based on the value of the property as of October 1 in the preceding year. These assessments are presumed to be valid.

During an appeal, county tax boards must determine the true market value of a property and then compare that value to the assessment. If the ratio of the assessment to true value exceeds the average ratio in the district by 15%, then the assessment is reduced. If the assessment falls with a common level range (each municipality has one based on inflation, appreciation and depreciation of property values) of either plus 15% or minus 15% of the average ratio, no adjustment will be given. If, however, the assessment falls below the common level range, the tax board may increase the assessment.

Municipalities also periodically engage in reevaluations throughout the entire taxing district or will conduct re-assessments of individual properties. This can be problematic for taxpayers in light of the current downturn of the real estate market as the potential exists that these new assessments will overstate the property's true value. If this occurs, property owners may be able to claim that their assessments are excessive or discriminatory and are not limited by the 15% common level range. Keep in mind that any assessment cannot exceed the market value of the property.

If you believe your current tax assessment is inflated or if your municipality has undergone a recent reevaluation, a tax appeal may be worthwhile. Appeals of this year's assessments must be filed on or before April 1, 2009 (or 45 days from the date the assessment was mailed, whichever date is later). If you have not received notice of this year's assessment, you should contact your local assessor and request this information. Give yourself time to investigate and file an appeal.

If you would like more information concerning tax appeals, please contact David M. Roskos, Esq. at (609) 989-5018 or droskos@sternslaw.com or Jennifer L. Cordes, Esq. at (609) 989-5027 or jcordes@sternslaw.com.

Bankruptcy and Creditors' Rights - FAQ

As the economic downturn continues, bankruptcy is now ever increasingly in the news. Sterns & Weinroth's Bankruptcy and Creditors' Rights practice has the breadth and depth of knowledge to advise clients in this uncertain financial time. What follows below is some guidance to the most common questions that are asked when a client is faced with a bankruptcy petition or financial crisis:

1. I am worried that my tenant (a corporation) is going to file a bankruptcy petition. Can I evict them if they do?

If they file a Chapter 11, you will have the right to receive rent going forward from the date the petition is filed. Why would you want to evict them? The company will retain the right to assume or reject the lease until they confirm a Chapter 11 Plan of Reorganization. "Assumption" means that the lease is reinstated; "rejection" means that the Debtor has decided to breach the lease and must now vacate. If you want to hasten that decision (e.g., if you have another tenant interested), you can file a motion to compel assumption or rejection, but realize that the Debtor has the right to take its time before making this type of decision (although recent amendments have tightened this timeframe). If the Debtor decides to stay in the property, it will be required to assume the lease and pay any pre-petition past due rent. In the event of rejection (that will force the Debtor to move out), the pre-petition rent will be a general unsecured claim paid on par with all other claims.

2. I am worried that my landlord is going to file a bankruptcy petition. Can it evict me?

a. In the event that the landlord files a Chapter 11 or Chapter 7 and your lease is rejected, you need not move out. The rejection simply relieves the landlord of the obligation to perform its obligations under the lease, 11 U.S.C. § 365(i) means you get to stay for the term of the lease, paying the rent, deducting the costs of non-performance by the landlord. Of course, under these circumstances, moving out may be preferable. If the lease is assumed, there is no reason to move.

b. In the event that the mortgage on the property goes into default and foreclosure is started (either during a bankruptcy proceeding or instead of one), one of two things will happen: (i) you will be named in the foreclosure (giving you ample time to vacate) and eventually judgment will be entered terminating your lease; or (ii) you will not be named in the foreclosure and any buyer at a sheriff's sale will take the property subject to the terms of your lease. In the event that you have concerns about this, you may want to contact the lender directly and get the lender to agree that it will not name you in the foreclosure, so your lease will remain pending.

3. Can I continue to provide services to a Chapter 11 Debtor post petition? What are my rights if I do?

The only way that Chapter 11 Debtors are able to truly reorganize (and pay creditors what they are owed) is if companies continue to do business with them. For that reason, the Bankruptcy Code provides protection for companies that do business with Chapter 11 Debtors. Anyone who continues to do business with a Debtor and ends up unpaid because the case fails to reorganize holds a Chapter 11 administrative claim. This claim would be about as high a priority as comes in a bankruptcy proceeding —- paid on par with the lawyers (accountants and other professionals) for the Chapter 11 Debtor. As always there is a reason to be wary of doing business with any troubled business. Be certain to keep a close eye on the extension of credit, but at least you can take comfort in knowing that there is some protection,

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Bankruptcy and Creditors' Rights - FAQ *(continued from page 6)*

4. If one of my competitors files a bankruptcy petition, how can I buy their assets?

The first answer is to recognize that not every bankruptcy results in the immediate sale of assets. Barriers to sale include (i) if the case is a Chapter 11 proceeding the assets are used for reorganization, although some assets may be for sale (e.g., unnecessary equipment); (ii) if the case is a Chapter 7 proceeding, the assets are, in theory, for sale, but if a bank has a lien, a Trustee appointed to liquidate the assets, may not be able to sell them; (iii) the assets will need to be sold for fair value, so you should not expect an extraordinary deal, particularly since any sale is subject to Court approval and the possibility of a competing bid. A quick review of the bankruptcy petition and docket in the bankruptcy proceeding can provide insight into whether the assets will be for sale.

5. My customer says that he is "teetering on the financial brink;" he may be filing a bankruptcy petition. Should I ship to him and under what terms?

Many vendors live in fear of receiving a preference – it is unfounded. Receiving a preference is not a crime – it only means that a creditor has been paid on an outstanding invoice within 90 days of a bankruptcy filing and as a result received more than it would have received on this obligation had it not received that payment. What is important to know is that a "preference" only exists ***if*** a bankruptcy petition is filed (and frequently it is not). Take the money, but beware that there may be a claim asserted down the road. The ***best*** terms on which to ship goods to avoid a preference is COD. Payments received for goods shipped COD ***are immune to preference attack***. If you must extend credit, do so on terms that mirror the terms that you had generally given previously. Remember, even if you receive a demand for a preference, you will probably not be required to give ***all*** of the money back, so you will be ahead of the game. In other words, always take the payment.

6. Last week, I delivered a huge shipment of goods to my best customer and I just learned that they filed a Chapter 11 bankruptcy petition today. What can I do about this last shipment?

Assuming that you shipped on credit, your remedy is to demand "reclamation". Reclamation is, in theory, return of the items shipped. To be entitled to reclamation, you must make the demand (i) in writing; (ii) within 20 days of the bankruptcy filing; (iii) for goods delivered within the "last" 45 days[1]. The reclamation claim will fail if the goods have already left the Debtor's possession (i.e., been resold) or have been modified (i.e., raw materials used in manufacturing). If you prove a right to reclamation, you may have the choice to recover your goods or be allowed a Chapter 11 administrative expense claim (instead of the usual pre-petition claim) which you may then request be paid immediately – with varying levels of success.

7. I have leased equipment to a company hovering on the brink of bankruptcy. I am protected, right?

There are two things to be aware of:

a. The fact that you may have called your transaction a "lease" does not necessarily mean that you have a lease and have retained title to the property that is covered. Courts will consider the "financial realities" of the transaction before deciding what the transaction should be called. If the lease term extends for the "useful life" of the leased property and if there is a mandatory buyout for a nominal amount – these are all terms that a court considers.

b. Since a Court may consider the transaction to be a secured transaction (and not a lease), make certain that you have filed a UCC financing statement to "perfect" your lien. Make sure that any filed UCC has not expired. Double check (and triple check) the status of your perfection! Secured creditors with properly perfected liens have rights in a bankruptcy proceeding that are very valuable.

8. Should I file a proof of claim?

Yes. Filing a Proof of Claim is not always required, but since there is little harm in filing one (unless, for some reason, you are trying to avoid being subject to the jurisdiction of the bankruptcy court) ***do it.*** It ensures that your claim is properly recorded, that your address is correct and that you will get the notices that you are entitled to receive. It is a very simple process, so there is no downside.

9. Why is my neighbor driving around in a brand new car, just returned from a European vacation and living in a big house after just having filed bankruptcy?

a. *It's not hard to explain:* the car is leased; the house is liened up to the extent of its value; the trip was paid on credit cards before they filed for bankruptcy. Your neighbors don't really own anything, so they have nothing to lose in a bankruptcy filing.

b. The Bankruptcy Code only requires the sale of assets of Debtors that will result in money for distribution to unsecured creditors. The neighbors will keep these assets and their debts (secured debts are not discharged in a bankruptcy proceeding) if they can pay for them.

Visit us at www.sternslaw.com to learn more about out Bankruptcy/Creditor's Rights Practice Group or contact Andrea Dobin at (609) 989-5053 or adobin@sternslaw.com.

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[1] This is the general rule, but there are intricacies to the "counting of days" that need to be applied on a case-specific basis.

Litigation Practice Group

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