

# hearsay!

The Law Offices of Hemar, Rousso & Heald, LLP

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## Sidebar

This issue of HearSay brings news of recent changes in California state law and Federal bankruptcy law relating, respectively, to the effectiveness of contractual jury waiver clauses and defenses to preference actions. We encourage you to read about the potential effect these changes may have on matters of interest to you.



As always, if there is a topic you would like to see addressed in the future, or if you have questions regarding the material contained in this or any other issue of HearSay, please let us know.

— Daniel A. Heald

## In this Issue

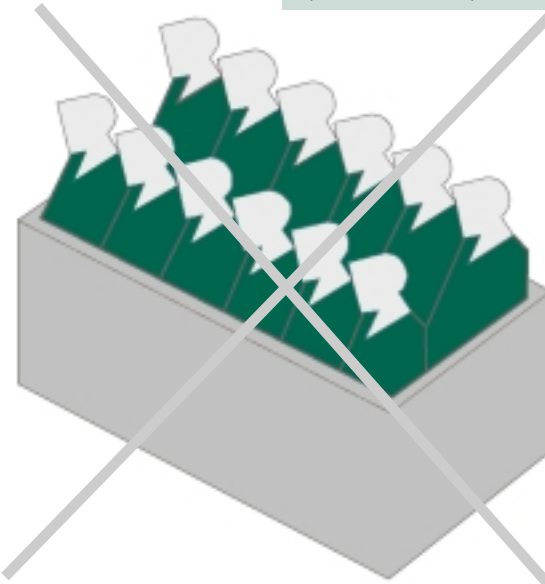
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# Waive Goodbye?

Contractual jury waivers are a significant, beneficial tool that equipment lessors, banks and other companies employ to streamline litigation and reduce costs. Many legal experts advocate their use as a substitute for full-blown jury trials and arbitration, and the legality of such waivers has been upheld by at least one California appellate court (the Second District, which includes the Los Angeles area). But a recent case handed down by California's First District Court of Appeal, which includes the San Francisco area and 11 other northern counties, has thrown the issue into dispute. The matter eventually could be decided by the California Supreme Court, and many prominent organizations, including the California Bankers Association, have weighed in on the issue.

The case is Grafton Partners, L.P. v. Superior Court of Alameda County (2004) 115 Cal.App.4th 700. The real party-in-interest is the giant accounting firm PriceWaterhouseCoopers, L.L.P. ("PWC"). Grafton Partners had hired PWC to perform audit work, and the parties' agreement contained a jury waiver provision. Eventually a dispute arose between them, and Grafton Partners

sued for breach of contract. Grafton Partners filed a jury trial demand, and PWC asked the trial court to strike the demand based on the contractual jury waiver. The trial court complied. On appeal by Grafton Partners, the decision was reversed, and a jury trial was ordered despite the express language of the jury waiver and the fact that both parties were sophisticated business entities.



The appellate court's reasoning was based on a strict reading of the California Constitution and the legislative history of Code of Civil Procedure § 631. That statute describes six different ways in which a party can waive a jury trial, none of which are by prior written agreement before a

lawsuit is filed. All of the listed waivers can occur only during a pending civil action (for example, by failing to pay jury fees or by written consent filed in court or verbal consent stated in open court or by failing to appear at trial). The court held that since the California legislature had not included contractual jury waivers in section 631, it was wrong for the trial court to uphold such a provision because that outcome improperly expanded the statute's scope and amounted to judicial legislation. The

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# Whacking the Double Whammy:

## *THE GOOD NEWS ABOUT PREFERENCE ACTIONS*

**Y**ou know the feeling. Not only did your customer file for bankruptcy, leaving you with a claim that will return cents on the dollar, but also you have to worry for another two years that the trustee, the creditors' committee or the debtor itself, will knock on your door asking you to return the payments you received within ninety days of the bankruptcy filing. It's a real double whammy.

In technical terms, a preferential payment or "transfer," under 11 U.S.C. § 547(b), includes all of the following elements:

The transfer was (1) made to or for the benefit of a creditor; (2) on account of an antecedent debt, (3) made while the debtor was insolvent, and (4) made within 90 days before the date of the filing of the bankruptcy petition, or between 90 days and one year before the date of the filing of the petition, if the creditor at the time of the transfer was an insider; and (5) the transfer enabled the creditor to receive more than it would receive had the transfer not been made and the case liquidated pursuant to the provisions of Chapter 7 of the Bankruptcy Code.

The idea that the same guy who paid you can turn around and ask — actually, demand it back, and sue you for it, is inconceivable. However, as part of the Bankruptcy Code enacted in 1978, Congress decided to spread the joy of the bankruptcy evenly among all general unsecured creditors, by requiring many of the creditors to give back most payments received during the 90-day preference period.

One of the problems with this provision is that the demanding party rarely imposes

any self-restraint in determining whom to sue. Most preference actions appear to be the result of the plaintiff reviewing the debtor's check register, and simply filing suit against every creditor who received any payment during the preference period, regardless of defenses that would be obvious with even the slightest bit of investigation by the plaintiff.

From a cynic's perspective, the reason for this is pure economics: most creditors are willing to pay at least some portion of the demand, because it is cheaper than hiring an attorney to defend the preference action. A plaintiff who files 100 preference actions, and settles for only \$1,000 each, has just "found" \$100,000 for the estate! At this point, the Bankruptcy Code provides little deterrent to plaintiffs for filing such actions, because neither party is allowed attorney's fees under any applicable law.<sup>1</sup>

**Until recently, if the "ordinary course of business" defense was your only defense, it was time to get out your checkbook...**

That is the recap of the bad news.

Now for some good news. For those of you facing preference actions in the Ninth Circuit (California, Arizona, Hawaii, Alaska, Arizona, Washington, Oregon, Montana, Nevada, Idaho and Guam), your luck is starting to change.

For the many years that Hemar, Rouso & Heald, LLP has defended

preference actions, available defenses generally have been limited to a combination of attacking any of the five elements of the alleged preference and/ or to raising the specifically enumerated defenses in 11 U.S.C. § 547(c), which are "new value," "contemporaneous exchange," "purchase money," and "ordinary course of business." Until recently, if the "ordinary course of business" defense was your only defense, it was time to get out your checkbook and try your best to negotiate a discount. Now, thanks to Ganis Credit Corporation v. Karl T. Anderson (In re Jan Weilert RV), 315 F.3d 1192 (9th Cir. 2003), the "ordinary course of business" defense is your first and strongest defense.

Prior to Weilert, and currently, throughout the rest of the country, the "ordinary course of business" defense requires the creditor to show that the alleged preference payments, even if late and sporadic, were made consistent with the debtor's pre-preference period payment history with that creditor, and that such a payment pattern was not inconsistent with the standard payment practices in the industry. Indeed, this is a very difficult standard for any creditor to meet. A recent example appeared in Delaware, where the debtor had been paying an average of 25 to 47 days late prior to the preference period, and 78 days late during the preference period. The court determined that the 20 to 40 day lag in the payment pattern reflected a marked shift in payments on accounts receivable. Consequently, the creditor's "ordinary course of business" defense failed, and the debtor was awarded \$239,366.10. Ameriserve Food Distribution,

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## Waive Goodbye?

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appellate court also defended its decision by citing to California's constitutional history, which in the Court's view, reflected "an unwavering commitment to the principle that the right to a civil jury trial may be waived only as the Legislature prescribes, even in the face of concerns that the interests of the parties and the courts would benefit from a relaxation of this requirement." See *id.* at 707.

Curiously, the Grafton court reiterated the enforceability of arbitration clauses, which by their nature involve an implicit waiver of a jury trial, but are not specifically addressed in section 631. The court reasoned that agreements to resolve a dispute "in a non-judicial forum, which leads to a loss of a package of rights" were fundamentally different from contractual agreements to "modify the judicial forum to eliminate one of those rights." See *id.* at 712.

The Grafton decision runs smack into the only other California appellate case on the issue — one that ruled the exact opposite. Until Grafton, as a general matter, contractual jury waiver clauses were enforceable in California, except in very limited instances. See [Trizec Properties, Inc. v. Superior Court](#) (1991) 229 Cal. App. 3d 1616. Trizec involved a breach of a commercial lease that contained a jury waiver clause. Plaintiffs, without explanation, unsuccessfully sought relief from the waiver. The clause's validity was upheld. Despite this, the Trizec court did point out that jury waivers are not absolute and can be struck down if a party unwittingly signs (or is tricked into signing) a document that imposes such a waiver. See *id.* at 1618. But such limited instances supporting unenforceability of jury waivers are a far cry from the blanket prohibition suggested by the Grafton decision.

So far, California's highest court has not decided if it will take up this issue anytime soon to reconcile the split between the state's two most influential appellate courts. Until that split is resolved jury waivers should remain in all contracts.

— Peter J. Veiguela

## Whacking the Double Whammy

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[Inc. v. Transmed Foods, Inc.](#) (In re: [Ameriserve Food Distribution, Inc.](#)), 2003 Bankr. Lexis 945 (Del. Bankr. 2003). This outcome is not uncommon outside of the Ninth Circuit.

Enter the Weilert court which held that the court must look to "those terms employed by similarly situated debtors and creditors facing the same or similar problems," and that "creditors are not required to prove a particular uniform set of business terms", rather, " 'ordinary business terms' refers to the broad range of terms that encompasses the practices employed by those debtors and creditors, including terms that are ordinary for those under financial distress... ." Only a transaction that is so unusual or

uncommon "as to render it an aberration in the relevant industry," falls outside the broad range of terms encompassed by the meaning of "ordinary business terms."

By this ruling, Weilert has placed the "ordinary course of business" defense at the top of every creditor's list of defenses, because it requires the court to consider the business practices of debtors who are in financial distress. This Ninth Circuit case is binding on a significant portion of the country, unless and until it is overruled by itself or the United States Supreme Court. Now, even if a creditor's only defense is the "ordinary course of business," the creditor in the Ninth Circuit stands a substantially higher chance of prevailing at trial, and thus, is in a stronger

position for settlement and possibly, the avoidance of any preference action at all.

— Jennifer W. Crastz

<sup>1</sup> *This is not to say that a creditor should ever defend a preference action when no reasonable defense exists. Any party who files or defends an action with no legal basis is subject to punitive sanctions under Federal Rule of Bankruptcy Procedure 9011 if the prevailing party can prove wilfulness and bad faith.*

## In Memoriam

It is with great regret and sadness that we write of the sudden passing of our beloved Sam Gordon. Although Sam left HRH a short while ago to work closer to his Santa Monica home, he spent some 27 years at HRH and we miss him. As our tribute to Sam, we have compiled a few comments from some of us who worked with him over those years:

"I have known Sam for 27 years. He was our walking Witkin. He could always tell me exactly what code section I needed to check when I needed to check some authorities. Sam sincerely wanted to know what was going on in your life. He remembered the names of children and spouses of employees."

"Sam truly loved practicing law and teaching the law to those around him. Every time I hear a bad pun, I think of Sam and smile.

I never once saw Sam angry or moody. He was always there for social conversation, as well as legal advice, and he loved both."

"I appreciated Sam's generosity of both his time and knowledge. He will be missed for his wit and charm, as well as his substantial contribution to the practice of many lawyers."

"Sam was one of a kind. He had a brilliant mind and a heart of gold."

"Sam was always ready to decipher any legal issue with a wealth of background. Whether it was case law, or a funny story, he knew what was appropriate for the situation."

"Sam was the first friendly face I encountered on my first morning at HRH. He put me at ease by asking about my background and never bragged about his. He would often stop by my desk, telling a joke or two or asking me if I knew a piece of

musical trivia or history. Sam brightened my day every time he stopped to chat. It wasn't until I saw other co-workers, past and present, at his funeral that I realized he made everybody else feel special too."

"When speaking of Sam Gordon, the man, a simple phrase such as 'generous of spirit' is transformed into an axiom."

"Sam was cool enough that, even though I hadn't been working at HRH that long, he invited me and my wife to spend the 4th of July with him and his family."

"It was great fun talking to Sam about the Los Angeles of the '50s and '60s when we were both youngsters here. He had an amazing recall of places and people of the time and enjoyed playing the 'Do you remember...' game immensely."

"Sam was a punny guy."

# HRH

## Happenings: Spring 2004

### RACKING UP THOSE FREQUENT FLYER MILES..... ✈

Partner Steve Jenkins recently was appointed Chairman of the United Association of Equipment Leasing (UAEL) Standards Committee. In that capacity, he is scheduled to speak to UAEL members on May 11, 2004 in Los Angeles, on the topic of the California Finance Lenders License. Being in great demand, Steve will also serve as a moderator and speaker at the 2004 Equipment Leasing Association (ELA) legal forum in New Orleans from May 2 through May 4.



In late April 2004, Associate Irwin Wittlin will attend the 4-day Spring 2004 UAEL conference in Phoenix. Also a popular speaker, on May 19, 2004, Irwin will address the Motion Picture and Television Credit Association about effective collection practices and strategies.



In the middle of May, Partners Dan Heald and Susan Breen will attend the 3-day Legal Counsel Seminar jointly presented by the California Banker's Association and the State Bar of California, Business Law Section, in Huntington Beach, California.

### NEW ARRIVALS

We send big CONGRATULATIONS to Legal Assistant Edgar Pacheco and wife Lisa who welcomed their first child, Damien Tomas Pacheco, to the world on April 10, 2004. Edgar assures us that Damien, in addition to being very spoiled, will be well-schooled in the finer points of hot-rodding and motorcycles.

Also, our best wishes go out to Associate Jenifer Hendershot and husband, Issac Homer Lassiter IV, who enjoyed a somewhat delayed honeymoon to beautiful Chile and Argentina last December. They are now expecting their first child, Finnegan Aiden Lassiter. Both Jenifer and Isaac are looking forward to the joys of parenthood: lack of sleep, lack of time, and piles of laundry.

The Law Offices of Hemar, Rousso & Heald, LLP 15910 Ventura Blvd., 12th Floor, Encino, CA 91436, 818/501-3800, FAX 818/501-2985. The firm specializes in the fields of commercial and consumer litigation, collections, bankruptcy and general corporate matters. Individual lecturers on the topics contained herein, as well as others on request.

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