

**WAGNER,  
FALCONER &  
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Welcome to the first edition of our newsletter. WFJ is pleased to present it to you on a quarterly basis.

The articles will cover business-related legal topics with emphasis on creditor's rights and related issues. Since many of our clients provide goods and services on a regional and national basis, the articles will cover legal developments throughout the United States.

WFJ has been engaged in the commercial practice of law dating back to 1932 when the firm was founded

by the late Clarence J. Wagner. Throughout its history, the focus of the practice has been creditor's rights with special emphasis on the construction industry. The firm employs 34 attorneys with an equal number of support staff. Our offices are located in Minneapolis, Minnesota and Milwaukee, Wisconsin.

We intend to publish articles on current legal developments for companies who extend credit throughout the U.S. as well as other business-related articles we think will benefit our clients.

We hope that you will find the articles both interesting and helpful. This edition covers the new changes to the Bankruptcy Code, recent court decisions on Wisconsin and Rhode Island construction projects, and non-compete agreements. We welcome your comments and suggestions for future topics.

Thank You.

Alan Falconer, President,  
and the Attorneys and Staff  
at WFJ.

**BANKRUPTCY BILL BECOMES LAW**

**Special Points Of Interest**

- Significant Changes to the Bankruptcy Laws
- Holmen Concrete Products Co. vs. Hardy Construction Co.
- What Employers Should Know about Non-Compete Agreements

On April 20, 2005, President Bush signed into law the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("the 2005 Amendments"), which bring about some of the most sweeping changes to the Bankruptcy Code ("the Code") since its enactment in 1978. With limited exceptions, the 2005 Amendments take effect on October 17, 2005, and are applicable to cases filed on or after that date.

The primary focus of the 2005 Amendments is on consumer

bankruptcies, where the changes are intended to make it more difficult for consumer debtors with some ability to pay their debts to discharge those debts in bankruptcy. However, in this article, a number of significant changes affecting business bankruptcies are highlighted.

**Defense of Preference Actions**

The Bankruptcy Code permits the trustee to "avoid" certain transfers made by a debtor up to 90 days before the date the

bankruptcy case was filed, subject to various exceptions. Under one of these exceptions, the trustee is not permitted to avoid a payment of a debt incurred by the debtor in the ordinary course of business if it was made both (1) in the ordinary course of business *and* (2) according to ordinary business terms. Under the 2005 Amendments, such transfers are unavoidable if made either (1) in the ordinary course of business *or* (2) according to ordinary business terms. Accordingly, a creditor may be able to defend

# Bankruptcy Bill Becomes Law

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a preference claim by showing that a payment received from the debtor during the 90-day preference period was “ordinary” based upon either the prior conduct of the parties or common industry practice. The creditor no longer must show that both standards are met. Under this more lenient standard, fewer transfers will be subject to avoidance.

In another significant change included in the 2005 Amendments, the trustee may not avoid a transfer made during the preference period if the value of the property is less than \$5000. The amendment will reduce the number of preference claims asserted by bankruptcy trustees by weeding out the small preference claims that do not meet the threshold.

## Fraudulent Transfers

Under existing law, the trustee was permitted to avoid transfers made by the debtor within one year before the date the bankruptcy case was filed, if the debtor made the transfer with actual intent to defraud creditors. The 2005 Amendments expand the so-called “look back” period to two years, but this change will not go into effect until April 20, 2006.

## Reclamation

Under existing law, the trustee’s right to avoid certain fraudulent or preferential transfers was subject to a creditor’s right to reclaim goods sold to the debtor in the ordinary course of business while the debtor was insolvent. In order to exercise the right of reclamation under existing law, the seller must make a written demand to reclaim the goods within 10 days after the debtor’s receipt of the goods. Under the 2005 Amendments, the time in which to make a written demand to reclaim the goods is extended from 10 days to 45 days. As under existing law, if the deadline expires after the commencement of the bankruptcy

case, the notice must be given no later than 20 days after the date the bankruptcy case was filed.

The 2005 Amendments also provide that a creditor who fails to make timely written demand to reclaim goods may still assert an “administrative expense claim” for the value of goods received by the debtor in the ordinary course of business within 20 days prior to the commencement of the bankruptcy case. The Code gives administrative expense claims special priority over claims of general unsecured creditors

These changes are expected to significantly increase the number of administrative expense claims in future cases, which may reduce payments to unsecured creditors and make it harder for debtors to obtain confirmation of their reorganization plans.

## Unexpired Leases of Nonresidential Real Property

Under existing law, upon the filing of a bankruptcy case, a landlord under a business lease between the landlord and the debtor is generally precluded from enforcing defaults under the lease by commencing an eviction or other enforcement action against the debtor. Subject to court approval, the debtor (or trustee) is permitted to “assume” or “reject” the unexpired lease, which will depend on whether the debtor thinks the lease will provide value over its unexpired term.

Under existing law, the debtor must make a decision to assume or reject the lease within 60 days after the commencement of the case, but the court has discretion to extend the deadline “for cause.” Existing law places no limitation on the number or duration of extensions that the court may grant. In more complex cases, especially where the debtor has an interest in a large number of properties, the debtor

often tries to postpone its decision on whether to assume or reject the leases as long as possible since the value of unexpired leases may be uncertain until the debtor is closer to having a reorganization plan approved. Multiple extensions of any significant duration can present problems for landlords who are forced to deal with longer periods of uncertainty.

The 2005 Amendments extend the initial period in which a debtor must decide whether to assume or reject an unexpired business lease from 60 to 120 days. Although the bankruptcy court continues to have discretion to extend the deadline for cause, the court may grant only one 90-day day extension. Any further extensions of the deadline require the prior written consent of the landlord.

These changes benefit landlords by substantially limiting the period of uncertainty landlords are exposed to under existing law. Under the new law, a debtor will be allowed no more than 210 days to assume or reject unexpired business leases, unless the landlord consents to a longer period of time.

The changes outlined in this article highlight only some of the significant developments brought about by the 2005 Amendments. Time will tell if the new legislation accomplishes its intended purpose of making the bankruptcy system fairer to both creditors and debtors.

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## Rhode Island Supreme Court Declares Lien Laws Constitutional

In an important decision for contractors and suppliers who rely on mechanic's lien rights, the Rhode Island Supreme Court recently examined the constitutionality of the state's lien law found at G.L. 1956 Chapter 28 of Title 34. The basis for the High Court's examination was to review the Gem Plumbing and Heating Co., Inc. v. Rossi decision of 2002 (Court held that the mechanic's lien law was unconstitutional based on a lack of appropriate due process afforded the homeowner) in light of the legislature's amendment of the mechanic's lien statute on July 17, 2003.

The amendment to the lien law enhanced the rights of a property owner facing a me-

chanic's lien by allowing the homeowner access to a prompt post-deprivation hearing. At the hearing, the homeowner is entitled to demonstrate to the court that the mechanic's lien is invalid and should not attach to the property.

The court employed the Matthews-Doehr test in determining the amended statute's constitutionality. Under this test, the court looked at: (1) the significance of the private interest that will be affected by the prejudgment measure; (2) the risk of erroneous deprivation of property; and (3) other procedural safeguards.

Pursuant to this test, the Rhode Island Supreme Court determined that the amended

mechanic's lien statute is constitutional. The court held that the private interest affected by a mechanic's lien is significant. However, the risk of erroneous deprivation of a homeowner's property is significantly reduced by allowing a homeowner access to a post-deprivation hearing to argue that the lien should not attach.

The Rhode Island decision is a victory for contractors and suppliers who rely on lien rights to extend credit on private construction projects.

## Public Body Liable for Failing to Obtain Payment Bond

Under Wisconsin law, as in most states, a public body is required to obtain a payment and performance bond from the successful bidder on a public construction project. If the public body fails to obtain a required payment bond, in some states the governing statutes hold the public body liable to subcontractors and suppliers who furnish labor or material for the project and do not receive payment. (For example, see Minn. Stats. §574.29.)

In other states, such as Wisconsin, the statutes and case law have been unclear as to whether the public body is liable to unpaid subcontractors and suppliers if a payment bond is not furnished.

In 2004 Wagner, Falconer & Judd, Ltd., as counsel for two unpaid subcontractors and suppliers, was instrumental in obtaining a court decision in Wisconsin that holds a public body liable for failing to obtain a required payment bond. See Holmen Concrete Products Company v. Hardy Construction Company, Inc., 686 N.W.2d 705 (Wis. App. 2004). The trial court's decision was affirmed by a decision of the Wisconsin Court of Appeals, in July 2004. In December 2004 the Wisconsin Supreme Court issued an order denying the public body's petition for review of the decision of the Court of Appeals. 686 N.W. 2d 705 (Wis. 2004).

In 2001 the Village of Readstown, Wisconsin ("Village") contracted with a Prime Contractor for improvements to streets in the Village. Although Wisconsin Statutes Annotated §779.14 required the Village to obtain or "approve" a payment and performance bond, the Village did not obtain a bond.

Holmen Concrete Products Company ("Holmen") and Iverson Construction Company ("Iverson") each entered into a separate contract with the Prime Contractor to provide labor and materials for the project. When the project was completed, Holmen and Iverson both were owed approximately \$40,000 and the Prime Contractor was insolvent. Holmen and Iverson commenced suit in August 2002, seeking judgment against the Village for the unpaid balances, based on the Village's failure to obtain a payment bond. In December, 2003, the Vernon County Circuit Court granted summary judgment in favor of Holmen and Iverson, and against the Village. The Circuit Court held that the Village was liable because of its failure to require or approve a bond.

On appeal the Wisconsin Court of Appeals concluded "... that the Village is liable to Holmen and Iverson for damages incurred as a result of the Village's failure to require (the prime contractor) to obtain a

bond." 686 N.W. 2d at 711. The issue considered by the Court of Appeals was whether, under Wis. Stat. §779.14, a municipality is liable to unpaid subcontractors if the municipality fails to ensure that a prime contractor secures a payment bond. The Court of Appeals discussed, at length, a prior Wisconsin decision (Cowin & Co., Inc. v. City of Merrill, 233 N.W. 561 (Wis. 1930)).

In Cowin the Wisconsin Supreme Court held that the City of Merrill was liable to an unpaid subcontractor when the City failed to obtain a payment bond for a city project. On appeal in 2004 the Village argued that 1997 and 1998 amendments to Wis. Stats. §779.14 served to overrule the Cowin decision. The Court of Appeals did not agree. The Court of Appeals noted that "(t)he policies supporting the Cowin rule remain pertinent today. Municipal liability for failure to ensure that a contractor furnishes a proper bond protects subcontractors, taxpayers and the municipality itself ... A liability rule also 'insures a fairer prospect of better bids because it encourages the competition of all interested by the assurance of payment.' " 686 N.W. 2d at 711.

## Non-Compete Agreements

In an increasingly competitive job market for employees, many employers are resorting to the use of non-compete and non-solicitation agreements to prevent unfair competition and solicitation of their employees. Whether an employer is trying to protect its business interests and unique workforce or trying to attract employees from a competitor, the employer needs to have a strategy to successfully achieve these goals.

Since non-compete agreements are generally disfavored because they are a restraint of trade, an enforceable non-compete agreement must be both necessary to safeguard the employer's protectable interests and reasonable as between the parties. Generally, employer's have protectable interests in (1) customer goodwill, (2) confidential information, (3) trade secrets, and (4) customer

contracts. The non-compete agreement must not impose any greater restriction on the employee than is necessary to protect the employer's business. Once an employer's protectable interests are identified, the non-compete agreement must be reasonable in its temporal and geographic scope. Courts consider a variety of factors in determining temporal reasonableness. Typically, agreements of one-year, two-years, and sometimes three-years may be reasonable, but agreements of longer duration are susceptible to the "blue pencil" doctrine, in which a court may eliminate a provision in an agreement or re-write it to make it reasonable.

Geographically, non-compete agreements must be reasonable in scope so as not to preclude an employee from working in geographic regions where an em-

ployer does not do business or have a business interest. The reasonableness of the geographic scope usually depends on the nature of the business. For instance, if the business is a "mom and pop" store, the geographic restraint may only be a few miles. However, if the employee worked for a Fortune 500 company doing business throughout the world, the geographic restraint is likely to be greater in scope.

In an ever-growing global job market employers' utilization of non-compete agreements will continue to grow while the courts continue to define acceptable boundaries. Employers and employees should define their goals, recognize their obligations and consult legal counsel regarding the value, validity and affect of non-compete and non-solicitation agreements.

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