



**Boston Bar**  
ASSOCIATION

DECEMBER 2007

# Bankruptcy Law Section

## Newsletter

December 2007

A PUBLICATION OF THE BOSTON BAR ASSOCIATION BANKRUPTCY LAW SECTION

DECEMBER 2007

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# Section Co-Chairs' Corner

Dear friends and colleagues:

Our Section is making a difference!

The Large Firm Pro Bono Subcommittee, in conjunction with Volunteer Lawyers Project, launched its new pro bono "split representation" program using the resources of Boston's larger firms to represent indigent clients in adversary proceedings and contested matters. On November 2nd, we hosted our annual pro bono training seminar to be followed by brown bag lunches with seasoned consumer bankruptcy lawyers. The Consumer and Pro Bono Committees are working to formulate solutions to a number of issues plaguing pro se chapter 13 debtors such as reinvigorating the BBA Lawyer Referral Service's network of chapter 13 practitioners so that pro se filers can find affordable counsel. We worked closely with the Real Estate Bar Association on a new version of the Massachusetts Homestead Act, addressing many of the problems under the old act, and there is a real possibility for passage next year.

The Section's CLE and brown bag lunches continue to be popular and timely. We had a full house for October's lunch with Carol Kenner and Chris Barry-Smith as they walked us through the Attorney General's enforcement actions against certain subprime mortgage originators. November's lunch was equally relevant with Sanjit Korde leading a panel on foreclosure procedure, tactics and strategy. Continuing with the subprime theme, on January 16th, we are hosting a not-to-be-missed CLE on predatory lending. And on January 31st, the Young Lawyers and New Members Committees will be sponsoring a Young Bench Meets Bench program with four of our District's bankruptcy judges participating.

Let our Section help you make a difference. There are countless ways to participate and become an active member. Spend a couple of hours teaching a financial literacy class in a participating high school. Volunteer to speak at a brown bag lunch. Write a short article for this Newsletter. Join a Committee. These are just a few of the ways to get involved and give something back to your community without a lot of heavy lifting.

Enough preaching. Let me conclude by wishing you a happy, healthy and prosperous new year. L'Chaim!

- Douglas B. Rosner

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## Section Co-Chairs



**Douglas B. Rosner, Esq.**

Goulston & Storrs  
400 Atlantic Avenue  
Boston, MA 02210  
(617) 574-6517

[drosner@goulstonstorrs.com](mailto:drosner@goulstonstorrs.com)



**Donald R. Lassman, Esq.**

Law Office of Donald R. Lassman  
P.O. Box 920385  
Needham, MA 02492  
(781) 455-8400

[Don@Lassmanlaw.com](mailto:Don@Lassmanlaw.com)

# Calendar of Section Events

## Luncheon Series Meetings

The Bankruptcy Law Section will hold luncheon meetings from **12:15 to 1:45 p.m.** on the following dates, subject to change:

### Tuesday, December 4, 2007

Debt Re-Characterization presented by **James Wilton**.  
*This program will be held at Goulston & Storrs, A Professional Corporation. Please RSVP by November 30th to [kjoyce@goulstonstorrs.com](mailto:kjoyce@goulstonstorrs.com)*

### Tuesday, December 18, 2007

Dos and Don'ts in Consumer Bankruptcy

### Tuesday, January 15, 2008

New Members - Creditors' Rights Practice

### Monday, February 11, 2008

Business Update - BAPCPA - Program Chair: **Peter Baylor**

### Tuesday, March 18, 2008

Pearls of Wisdom from the Ch. 13 Trustee - **Carolyn Bankowski**

### Tuesday, April 15, 2008

This date is open for topic suggestions. Contact Section Co-chairs **Doug Rosner** or **Don Lassman** if you have a topic proposal.

### Tuesday, May 20, 2008

[Consumer Topic to be Determined]

### Tuesday, June 17, 2008

Debt Recharacterization under State Law. Presented by **James Wilton** and **Heather Zelevinsky**

*All meetings will be held at the BBA, 16 Beacon Street, Boston, unless otherwise noted. Please RSVP for the luncheon series meetings by calling the BBA Reservation Line at (617) 778-2030 or emailing us at [sections@bostonbar.org](mailto:sections@bostonbar.org).*

## CLE Programs

### Wednesday, January 16, 2008

**2:00 p.m. - 7:00 p.m.**

Beyond Basic Training: Predatory Lending in the Trenches;  
Program Chairs: **Susan Grossberg, Bill McLeod, Nina Parker**

### Thursday, January 31, 2008

**4:00 p.m. - 7:00 p.m.**

Young Bar Meets Bench: Introduction To the Judges and Insight into the Bankruptcy Court and Practice.  
Reception to follow. Program Chairs: **Peter Acton, Alex Mattera, Natalie Sawyer, Chip Azano**

### Thursday, April 17, 2008

**3:00 p.m. - 7:00 p.m.**

BAPCPA consumer law update; Program Chair: **Nina Parker**

### Thursday, May 15, 2008

**3:00 p.m. - 6:00 p.m.**

18th Annual Bankruptcy Bench Meets Bar Conference  
Reception to follow  
Colonnade Hotel Program Chair: **Don Lassman**

## Upcoming Special Events

### Friday, December 7, 2007

**5:30 p.m. - 7:30 p.m.**

6th Annual Pro Bono Holiday Reception  
*Sponsored by BBA New Lawyers Section*  
BBA, 16 Beacon Street, Boston

## CONTRIBUTORS

Alan D. Lasko & Associates, P.C.

David G. Baker

Paul Hodnefield

Bill McLeod

## EDITORS

Guy B. Moss

John T. Morrier

## Members in the News

**Rick Mikels**, First Circuit Regent for the American College of Bankruptcy, has announced that the following have been selected as Fellows:

**Stephen S. Gray**, managing partner of CRG Partners Group LLC in Boston;

**John J. Monaghan**, partner at Holland & Knight LLP in Boston, and national practice group leader of the firm's corporate restructuring, insolvency and creditors' rights practice group;

**Christopher J. Panos**, managing shareholder of Craig and Macauley Professional Corporation in Boston; and

**John Rao**, an attorney with the National Consumer Law Center in Boston.

## Job Posting

### Clerk of Court

United States Bankruptcy Appellate Panel for the First Circuit  
Boston, Massachusetts

The United States Courts for the First Circuit seeks a Clerk of Court for the Bankruptcy Appellate Panel (BAP). The Clerk is responsible for the administration of all non-judicial functions of the BAP, including case processing, reporting requirements, and coordination among all BAP judges. The Clerk will also perform substantive legal work. A law degree is required, and experience practicing bankruptcy law is preferred. Candidates must also possess a minimum of 10 years of progressively responsible administrative and managerial experience and a thorough understanding of the organizational, procedural and human aspects of managing an organization. Salary: \$95,705 - \$124,415. Send a letter of application and a resume by close of business on Friday, December 14, 2007 to Gary H. Wentz, Circuit Executive, Office of the Circuit Executive, 1 Courthouse Way, Suite 3700, Boston, MA 02210. The successful candidate is subject to an FBI background check and investigation as a condition of employment.

## MURPHY'S LAWS

"Everyone has a scheme for getting rich that will not work."

"Build a system that even a fool can use, and only a fool will use it."

"If you're feeling good, don't worry. You'll get over it."

"If you try to please everybody, nobody will like it."

"A short cut is always the longest distance between two points."

# Assessing the Dimension of Business Fraud

By Alan D. Lasko & Associates, P.C.

The problem of business fraud permeates organizations of every size and at every level. Regularly, public and private business officials and managers, labor leaders, politicians, and other high profile individuals are found to have committed fraud, to be participants in a “culture of corruption.” Indeed, one of the inarguable truths about fraud is that — much like death and taxes — it will always be with us.

There are, of course, periodic efforts at mitigation. In 2002, President Bush addressed the problem, vowing that his administration would “end the days of cooking the books, shading the truth and breaking our laws.” “The business pages of American newspapers,” he said, “should not read like a scandal sheet.” That was the year the President signed into law the Sarbanes-Oxley Act mandating stricter rules to reduce the risk of fraud in financial reporting.

Debate continues over whether the law is too strict and stifles businesses or too lenient and fails to adequately address the fraud problem. Most observers agree it is still too soon to assess the law’s impact.

Meanwhile, in 2006, four years after Sarbanes-Oxley was passed, several high profile former corporate leaders were sent to jail for fraud:

- Jeffrey K. Skilling, the former chief executive of Enron, was sentenced to 24 years in prison for his role in the fraud and conspiracy at the company.
- Sanjay Kumar, former chief executive of Computer Associates, received a 12-year prison sentence after pleading guilty to fraud and obstruction of justice for participating in a \$2.2 billion accounting fraud at his company.
- David C. Wittig, former chief executive of Westar Energy, a Kansas utility, got an 18-year sentence for looting millions from the company.
- Stuart Wolff, founder and chief executive of Homestore, an online real estate listings concern, was found guilty of insider trading, lying and conspiring, and received a 15-year sentence.

Such high profile cases receive a great deal of publicity. Are they the “tip of the iceberg,” the visible portion of an underlying problem of great magnitude? Or are they “just a few rotten apples” and not indicative of a greater problem? In other words, how common is business fraud? And is it on the increase?

At the outset, it must be admitted that anything like certainty in answering either of these questions is impossible. When fraud is uncovered, businesses often do not reveal it publicly. The reasons include concern about the possible impact on stockholder value, fear of regulatory scrutiny, worry about being sued for improper controls, professional embarrassment, fear of bad publicity, or just unwillingness to confront and deal with the repercussions. There is obviously no way to measure the tremendous amount of fraud that remains unreported.

Comprising an even larger area of the problem, most fraud is never discovered, so, obviously, that cannot be calculated.

Barriers to accuracy notwithstanding, the Association of Certified Fraud Examiners (ACFE), accounting firms, and various other experts have done their best to get a handle on the incidence and extent of fraud. This article looks at some of their findings, as well as at various efforts to determine whether dishonesty is increasing.

## Professional Opinion

Each year the ACFE publishes a report on occupational fraud. Concerning the extent of the problem, the mean estimate by the more than 1,000 certified fraud examiners who participated in the 2006 ACFE study<sup>1</sup> is that 5 percent of the annual revenues of a typical U.S. organization are lost to fraud. Based on the 2006 U.S. gross domestic product, that would mean about \$652 billion lost to fraud. Just to put that amount in perspective, through the end of 2006, about \$350 billion had been spent on the Iraq War.

For its 2006 study, ACFE examined more than 1,100 cases of occupational fraud that were investigated over the last two years. The median dollar loss from these schemes was \$159,000. One-quarter of the frauds

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studied resulted in losses of \$1 million or more and there were nine cases with reported losses of at least \$1 billion.

More than 91 percent of the frauds ACFE studied involved some type of asset misappropriation. This is any scheme that involves the theft or misuse of an organization's assets (for example, fraudulent invoicing or skimming revenues). Those cases had median loss of \$150,000.

In about 32 percent of the cases, corruption was involved, such as accepting or paying a bribe or engaging in a transaction where there is an undisclosed conflict of interest. These cases had a median loss of \$538,000.

About 11 percent of the cases studied involved falsification of financial statements to make the corporation look more or less profitable. Though the least common, these cases were far more costly, with a median loss of \$2 million.

The percentages reported add up to more than 100 percent because many cases involved more than one type of fraud.

### **Future Indicators**

There is little reason to hope that the fraud problem will improve. On the contrary, sadly, there are many indicators it's liable to increase.

One indicator may be the rising number of corporations that have to restate their accounts. Back in the 1980s it was only a dozen or so each year. But in 2002, 330 companies restated their earnings, up from 233 in 2000. In 2004, 414 companies restated their financial statements. There has also been a rising trend in the number of periods contained in each restatement. For its 2003 Fraud Survey, KPMG interviewed more than 450 executives in medium-sized businesses and in state and federal government agencies. Three-quarters of the surveyed companies reported an instance of fraud, an increase of 13 percent over 1998. The rate of fraudulent financial reporting more than doubled since 1998.

The public believes dishonesty is increasing. In a 2006 Zogby Poll three quarters of those surveyed said the state of honesty in America is worse than it was when they were young, and 45 percent expect the state of honesty to decline in the next five years with only 13

percent expecting improvement.

More than three-quarters (77 percent) have less trust than they used to that corporations are doing the right thing by their employees.

Future business leaders are actually more dishonest than average, according to a recent study researchers call "alarming." A report by three academic researchers published last September in Academy of Management Learning & Education found that more than half of the graduate business students surveyed admitted to cheating at least once during the last academic year. The study found that among the 5,331 students at 32 graduate schools in the United States, most of whom were pursuing MBAs, 56 percent admitted they had cheated in the past year, compared with 47 percent of graduate students in nonbusiness programs. The students said the main reason they cheated was they believed that everyone else was doing it. "Many graduate business students have work experience where they have been exposed to the 'get it done at all costs' culture still found in many corporate workplaces," the report says.

### **An Era of Rising Temptations**

A piece of received wisdom among fraud examiners is that in the typical organization, 10 percent will be rotten apples inclined to criminality, 10 percent will have strong ethics and morals, and the other 80 percent could go either way depending on such factors as the culture and environment and the perceived likelihood of being caught and punished. Many believe that the scale today is tipped toward making that 80 percent more likely to commit fraud.

In *Trust and Honesty: America's Business Culture at a Crossroad* (Oxford University Press, 2006), author Tamar Frankel identifies a number of factors that cause her to conclude that for that 80 percent this is an era of "rising opportunities and temptations" to commit fraud. There is now a well-publicized runaway competition for compensation at the top of companies and the same is true in sports and entertainment, Frankel notes. America is becoming a "winner-take-all" system, which "amplifies people's tendencies to compare themselves to others and their salaries to the salaries of others. This leads to resentment of inequality."

"The compensation that corporate managers started collecting during the last decade of the twentieth century triggered envy and status building that drove to greed

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— the hunger without limits,” Frankel writes. Desire to be seen as a winner, resentment of inequality, greed, pressure to meet objectives with the implicit threat that the result of failure would be job loss — these pressures with only weak pressures for self-limitation are the conditions that promote increased fraud, Frankel says.

It’s true, she continues, that historically there have always been cycles of fraud and abuse and rebuilding of trust. Still, she argues, this era is different: “What is new, however, is the change in the balance between the pressure to gain, which may lead to fraud, and the personal and institutional barriers to dishonesty, which prevent fraud from rising.”

### Changes in How Fraud is Uncovered

According to the 2006 ACFE Report, most frauds are uncovered as the result of tips (34 percent) or by accident (25 percent). The fact that the discovery of fraud remains so haphazard and unpredictable indicates that organizations, which care about uncovering fraud, need “to do a better job of designing controls and audits to identify fraud,” the ACFE Report states.

An even more recent study, however, indicates change may be occurring in how fraud is uncovered. In a report entitled “Who Blows the Whistle on Corporate Fraud?” the nonprofit National Bureau of Economic Research (NBER) found that since the enactment of Sarbanes-Oxley, employee reports have actually declined as a source for the discovery of fraud. In the same period, the percentage of corporate fraud that was uncovered by audit firms has quadrupled, from 7 percent to 29 percent.

The NBER researchers studied all reported corporate fraud cases from 1996 to 2004 in U.S. companies with more than US \$750 million in assets. Prior to Sarbanes-Oxley, mandated detectors of fraud such as the Securities and Exchange Commission detected about 35 percent of frauds. After the enactment of Sarbanes-Oxley which increased incentives and penalties fraud detection rose to 55 percent.

Prior to Sarbanes-Oxley, the group which led in fraud detection was employees, but their involvement has declined from 20 percent of cases to 15 percent since the law took effect. Employees have too much to lose from blowing the whistle, according to the study’s authors. In 82 percent of cases where the whistleblower’s identity was known, the person was fired, quit, or saw significant changes in his or her job.

Recently, Treasury Secretary Paulson, corporate officials and others have complained that the onerous requirements of Sarbanes-Oxley make it difficult for US companies and financial markets to compete with foreign markets. Many would like to ease or eliminate the restrictions that were put into place to protect investors after the Enron scandal. Others complain that the restrictions did not go nearly far enough to root out and prevent fraud.

Regardless of what happens with Sarbanes-Oxley, business fraud at all levels — from the lowliest retail clerk taking a pack of cigarettes to a CEO ripping off millions — will almost certainly continue to be a pervasive, extremely costly problem.

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### Endnotes:

<sup>1</sup> The ACFE’s [Report to the Nation on Occupational Fraud and Abuse](http://www.acfe.com/fraud/report.asp) can be found at [www.acfe.com/fraud/report.asp](http://www.acfe.com/fraud/report.asp).

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### Editor’s Note:

Alan D. Lasko & Associates, P.C. is a firm of Certified Public Accountants located at 29 South LaSalle Street, Suite 1240, Chicago, IL 60603 (email: [alasko@adlassoc.com](mailto:alasko@adlassoc.com); telephone: (312) 332-1302; website: [www.adlassoc.com](http://www.adlassoc.com)). Among other services provided, it has worked extensively in the area of litigation support and bankruptcy accounting and tax preparation. Alan D. Lasko, CPA, CIRA, in particular, has worked primarily in the bankruptcy field over the last 22 years and has served as an expert witness, a receiver and a disbursing agent.]

# Mr. Baker Goes To Washington With Apologies To Jimmy Stewart

By David G. Baker, Esq.

While my sojourn before the United States Supreme Court on November 6, 2006, may have lacked the drama of Frank Capra's film, it nonetheless was the culmination, thus far, of an idealistic and perhaps naive belief that I can make a difference in the lives of my clients and also contribute to the development of the law. I have no doubt that the members of the bankruptcy bar in Massachusetts have the same goal, especially since a bankruptcy practice is not the easiest way to make money as a lawyer (after all, there's a reason our clients are in bankruptcy!). It is surely a labor of love for all of us.

It could be said – with some justification – that I got lucky. I had an issue that I felt strongly about (and in fact still do), that had not been decided by our Court of Appeals, and about which decisions in other circuits were in disarray: does a chapter 7 debtor have the absolute one-time right to convert the case to another chapter, free from any judicial inhibition? Courts in the First Circuit (below the Court of Appeals) and about half the other circuits said no, but the other half said yes. Then the First Circuit said no, also.

Recognizing that a “split among the circuits” is the classic basis for the Supreme Court to grant a petition for certiorari, I began giving serious thought to filing a petition. Given the split, one might wonder why certiorari had not been requested before. Frankly, I didn't; I only knew that I had an issue that the Supreme Court had not decided, so I decided to test the waters. Once again, I got lucky. The local consumer bankruptcy attorneys that I communicate with regularly thought I should give it a try. The National Association of Consumer Bankruptcy Attorneys (NACBA), which had provided amicus support at the First Circuit through John Rao, indicated a willingness to assist should I decide to take the plunge.

“Do I feel lucky?” With Clint Eastwood's line in mind, I bit the bullet and prepared a petition, got admitted to the Supreme Court (which is easier than you might think), and filed the petition on January 30, 2006. Initially, the other side did not respond to the petition. However, Mark DeGiacomo (the chapter 7 trustee in the case) got a call or a letter from the clerk's office indicating that the justices wanted him to file a response. He did, taking a rather neutral position, and on June 12, 2006, the

petition was granted.

I was not the first person to find out that the petition had been granted. That distinction belongs to NACBA, which has an office in Washington and monitors not only the Supreme Court but issues relating to consumer bankruptcy, generally. The organization has an amazing “listserv”, and the organization's members contribute hundreds of emails per day. Not surprisingly, therefore, the NACBA listserv was the first to know, resulting in a deluge of emails to me from other members expressing their views – both pro and con – about the excellent adventure before me.

The Supreme Court – the final frontier – was my destination; I was about to boldly go where no bankruptcy lawyer from Massachusetts had gone before since Guy Moss in 1990. Again, NACBA provided amicus support, this time from Craig Goldblatt and other attorneys from the Washington and Boston offices of Wilmer Hale. With their advice and assistance, I managed to file a coherent brief, ably supported by their amicus brief. Mark DeGiacomo (as chapter 7 trustee) and outside counsel (representing the other respondent, Citizens Bank) filed their briefs, and I filed a reply. Oral argument was scheduled.

As difficult and time-consuming as it is to write briefs<sup>1</sup>, preparing for oral argument was equally challenging. Although I have done numerous appellate arguments, I realized that it was unlikely that I would have the chance to argue a case before the Supreme Court again, given that they grant a tiny number of petitions in comparison with the number that are filed. This was most likely my one shot at fame, so to speak, and I had to make the most of it.

Again, luck was on my side. Craig Goldblatt and his team arranged for two moot court sessions with him and attorneys from his firm's Boston and Washington offices. The moot court “justices” were very knowledgeable about Supreme Court practice, but (for the most part) *not* knowledgeable about bankruptcy law or the practical side of the daily routine we all live with. This was quite realistic, since none of the Supreme Court justices has any practical experience in bankruptcy law either – certainly not on the consumer side! Thus while the

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moot courts were relatively informal, in comparison with the real thing, when they were over I truly felt I had been put through the wringer! Although oral argument at the Supreme Court is strictly limited to thirty minutes each for each side, these moot court sessions lasted between two and three hours each! After the second, which took place in Washington about five days before the big day, I felt that I was as prepared as I could ever be.

The best part of the final days leading up to oral argument is that although I was in Washington, I was among friends and family – my “cheering section”, although thankfully they did not cheer during oral argument. My mother flew up from Arkansas to attend; a cousin who lives in Washington (and is retired from a position in the White House) let me stay with her instead of in a hotel; and a half-dozen or so consumer bankruptcy attorneys from the Boston area made the trek – including Yu Jin Weng, my associate, and Jeff Kitaeff, who was on the brief as Of Counsel, having been my bankruptcy professor at Massachusetts School of Law.

The big day arrives. I meet Craig Goldblatt and Jeff Kitaeff at the side entrance to the court, where attorneys who are arguing are allowed to bypass the throngs of spectators. (In fact, the courtroom was full and included a bankruptcy judge from California, or so I’m told). Although neither Craig nor Jeff was allowed to argue, they were allowed to sit at counsel table since they were on the briefs. Craig, being an old hand at this, shepherds us through the maze to counsel table. On the stroke of the hour, the Clerk pounds the table with, I believe, a large rock, and the justices enter through the red curtains behind the bench – three from the left, three from the right, three from the center. My case is first on the list (the Court hears a maximum of two in the morning and one in the afternoon), but the first order of business is to admit a number of attorneys to the Supreme Court bar. Then, Chief Justice Roberts uttered those words that I had both feared and longed to hear: “We’ll hear argument first today in *Marrama versus Citizens Bank of Massachusetts*. Mr. Baker?”

As you can probably imagine, the next thirty minutes seemed to last forever, although it was over before I knew it. You can read the transcript for yourself; it is available at the court’s website. As experienced appellate practice attorneys will confirm, you want the court to ask questions since that means they are taking the matter seriously (even if some of the questions themselves are not so serious, as was the case here!). Fortunately, Chief Justice Roberts (who seems very comfortable in his role and fully in charge) weighed in with the first questions after only a couple of minutes, and the others chimed in after that, so I never had to resort to

my prepared argument. A large issue, from the Court’s perspective, was whether the case was moot for various reasons; I argued that it wasn’t. Although I had expected the issue to arise, I was a bit surprised at how much time they took with these questions, but then I realized that it only reflects the understandable and universal judicial desire to avoid making an unnecessary decision!

Once they finished with their questions, I had some of my 30 minutes left over, so I reserved that time for rebuttal. After the two opposing counsel completed their argument (and agreed with me that the case was not moot), the Chief Justice told me I had two minutes left, which I used and which generated more questions from the Court. Then the red light came on; it was all over, and the waiting began.

Before leaving the court building (notwithstanding the post-argument daze I was in) I joined my “cheering section” in visiting the court’s gift shop and picked up some memorabilia, including a brief bag embroidered with the court’s seal and a pen in the shape of a gavel. The most meaningful memorabilia, however, was the two quill pens that arguing counsel, and those sitting at counsel table, are given. Although I haven’t tried them, I am assured that they work, and they are truly unique since only those actually at counsel table are given them. I have them framed, along with some photographs of the day, on a wall in my office. If you’re really interested, you can see the pictures at my website: <http://homepage.mac.com/dgb137>.

I think I acquitted myself fairly well, although unlike Jimmy Stewart’s character, there was no filibuster. Except for Justice Thomas (who I’m told rarely asks questions), the justices all had questions to ask and points to make. There was most definitely a dialogue (a ten-alogue?) going on among us. During the argument, I realized, yet again, how important it is to view the advocate’s task as one of teaching the court about what you think the law should be and why, even at the very highest judicial level. This is especially true when the judge(s) do not deal with your subject matter daily, as the Supreme Court justices do not. Once I realized that, I felt less nervous arguing before the Supreme Court than I do arguing before our judges here in Massachusetts.

The decision was issued – ironically – on Ash Wednesday, 2007. As with the grant of certiorari, my colleagues on the NACBA listserv knew before I did! The court clerk did call later that day, but alas I was not in the office and so she left a message. The court affirmed, but only by a 5 – 4 vote. While losing is never a happy occasion, I do feel that the 5-4 vote was the best “loss” I could have

Continued

hoped for. I will have things to say about the opinions in a different context, but I feel that notwithstanding the affirmance, the result was a victory, albeit muted (yes, my nickname is “Pollyanna”). The majority decided it on the basis of “forfeiture”, an argument no one had made, either in the Supreme Court or below. This was quite a surprise, since I would have thought that my worthy adversaries would have raised that issue had they thought it a basis for affirming. We all know, however, that an appellate court can affirm on any ground reasonably reflected by the record, and since an appeal from the Supreme Court does not lie, we now have something new and surprising to think about! The dissent essentially adopted my argument, with (not surprisingly) its own take on certain points, which I found to be quite gratifying.

Odd as it may seem, I can’t truthfully say that this experience has made that much difference in my practice or my life. The first day back in court here in Boston, after the oral argument, was no different than any other day, although a number of colleagues privately extended congratulations, for which I am grateful. They know that I have never shied away from difficult cases, and as a result, most of my work results from referrals. I was already pretty well known among the consumer bankruptcy bar, having started out my career as counsel to Richard Askenase, who was the standing chapter 13 trustee at the time, so there really hasn’t been an increase in referrals (NB: my phone number is 617-367-4260, in case you were wondering). I think that clients are impressed by the fact that I argued before the Supreme Court, however, and perhaps find it somewhat comforting as well since it indicates to them that (like all of us, I’m sure) I will stick with them until the bitter end, so to speak.

The end result of this journey is that the law on this issue is now uniform across the country. The right to convert, which according to the legislative history is “absolute”, IS absolute *except* in the most egregious circumstances – whatever “egregious circumstances” means. In my brief I had suggested that if they affirmed, they would have to define “egregious circumstances”, but they refused to create a “bright line” rule. That makes some lawyers in other circuits unhappy, of course, since in their circuit the right to convert is now subject to judicial discretion, but doesn’t really affect us in the First Circuit. Ultimately, though, like most Supreme Court decisions, “there’s gold in them thar hills.” You jest have to know where to pan for it.

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**Endnotes:**

<sup>1</sup> Mark Twain has been quoted as saying: “I didn’t have time to write you a short letter, so I wrote a long one instead.”

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**Editor’s Note:**

Mr. Baker is a solo practitioner in Boston’s North End, 105 Union Wharf, Boston, MA 02109. His practice concentrates in consumer bankruptcy and related litigation. He can be reached at 627-340-3680 or by email at [david@bostonbankruptcy.org](mailto:david@bostonbankruptcy.org).

## DO YOU KNOW YOUR ACRONYMS/ABBREVIATIONS?

HEL

DIM

URL

WYSIWYG

HTML

HTTP

MTV

CSI

ADT

LUI

HVAC

SM

*(Answers on page 17)*

# UCC Termination Traps For The Unwary Searcher

By Paul Hodnefield, Esq.

Would an attorney want to close a deal in reliance on the results of an incomplete UCC search? The answer, of course, is no. A complete and accurate UCC search is essential for reducing the risk in commercial transactions. Nevertheless, many attorneys are in fact relying on insufficient search results without realizing it.

The reason is that some UCC searchers mistakenly believe it is safe to exclude terminated financing statements from the search results. They assume terminated records are no longer effective and no review is necessary. Thus, searchers often try to save time and money by omitting terminated records from the search.

This practice reflects a fundamental misunderstanding about the effect of a termination. It's also risky business. The filing of a termination statement does not mean the financing statement is no longer effective. Any party that relies on search results without adequate inquiry into the effect of termination statements could face substantial risk should the debtor later default or file for bankruptcy. There are a variety of circumstances that can cause a "terminated" financing statement to remain effective. Regardless of the reason, these records remain in the filing office index for searchers to discover. The diligent searcher has a responsibility both to identify these records and determine the effect of each.

## Ineffective Terminations

The reason searchers need to pay attention is that an unauthorized termination is not effective.<sup>1</sup> This is far from a hypothetical risk. Filing offices around the country receive thousands of unauthorized terminations every month. Many find their way into the UCC index. The odds are good that a searcher will come across one sooner or later.

Most unauthorized terminations are filed by accident, the result of data entry errors. The simplicity of the termination form accounts for much of the problem. A termination statement requires just two pieces of information, the initial financing statement file number and a check mark in the termination box.<sup>2</sup>

The most important piece of information is the initial file number. This is usually the only link to the initial financ-

ing statement in a central filing office.<sup>3</sup> If a termination provides an incorrect initial file number and it corresponds to another secured party's active financing statement, the filing officer associates the termination with that record. In that case, the actual secured party never authorized the termination and it is not effective.

It is very easy for filers to make an error in the initial financing statement file number. We're all human. Typos happen, either during preparation of the termination record, or even long before, when someone entered the filing information into a UCC tracking system.

A typo is just one event that can result in an unauthorized termination. Sometimes the original filing acknowledgment is difficult to read. Threes and eights can look a lot alike if the number isn't clearly stamped on the document. Readability only gets worse when the filer works from scans or faxes of the original document. This often results in an incorrect file number finding its way onto the termination statement.

Refinance transactions can also lead to unauthorized terminations. Sometimes the deal falls through after the prospective new lender terminates the active financing statements. Once filed, there is no way to remove the termination statement from the record.

When the transaction does close, the new lender is not necessarily authorized to file a termination simply by paying off the debtor's outstanding balance. The financing statement may cross-collateralize multiple transactions, or secure a future obligation to extend credit. With limited exceptions,<sup>4</sup> the secured party's authorization is still required to effectively terminate a financing statement.

Even an authorized termination is not always fully effective. This can occur where a financing statement has multiple secured parties of record. Under § 9-510(b), "A record authorized by one secured party of record does not affect the financing statement with regard to another secured party of record." In other words, a termination filed by one secured party does not necessarily terminate the security interests of the remaining secured parties. Every secured party of record must authorize the termination statement or the financing statement may remain effective.

Continued

Fraud is another source of unauthorized terminations. An example is where the debtor files terminations so the collateral appears unencumbered. This makes it easier to sell the collateral, or use it to secure new financing with an unsuspecting lender. The good news is that fraudulent action makes up only a small percentage of the unauthorized termination filings.

Regardless of the reason behind the filing of an ineffective termination statement, it's up to the searcher to catch it. If a party conducts a search without closely examining each terminated financing statement the consequences can be harsh. The secured party may not have first priority in the collateral if the debtor defaults or files for bankruptcy, resulting in a potentially substantial loss. Searchers must not only review terminated financing statements, but they must also know what traps lurk for the unwary.

### **Searcher Beware!**

An ineffective termination statement is only one of many risks inherent in the secured transactions search and filing process. Hidden liens, interpretive issues and non-uniform filing office practices all create risk that cannot be entirely eliminated. The risk can, however, be managed.

Revised Article 9 allocates the risk between filing secured parties and searchers. Initially, the filer has the responsibility to file its financing statement in full compliance with the statutory requirements. If the filer fails to carry this burden, it bears the risk of loss. When the filing secured party does fulfill its obligation, all the risk of error shifts to subsequent searching parties.

Searchers have the responsibility to conduct the search properly and to exercise reasonable diligence in analyzing the results.<sup>5</sup> The requisite diligence is not satisfied merely by a review of the search results.

Revised Article 9 uses a notice filing system. A financing statement is a notice that the secured party may have a security interest in the collateral indicated. "Further inquiry from the parties concerned will be necessary to disclose the complete state of affairs."<sup>6</sup>

The Code definition of "financing statement" in § 9-102(a)(39) includes the initial financing statement and any filed record relating to that record. Terminations fall within the scope of this definition.

The searcher has a responsibility to make further inquiries if there are questions about the effectiveness of a

termination statement. Considering the prevalence of unauthorized terminations, no search can be diligent without careful review of all terminated financing statements, including each termination statement.

Searchers are largely on their own when it comes to interpreting the effect of termination statements. The essential factor for determining effectiveness, authority to file, is not required to be reflected in the public record. Nor can the filing office provide any assistance. The role of the filing officer is purely ministerial.

Fortunately, Revised Article 9 ensures the searcher at least has access to all the information required to correctly interpret search results, including terminated financing statements. Unlike former Article 9, where filing offices routinely purged records immediately after the filing of a termination, Revised Article 9 requires the filing office to maintain all UCC records until one year after the financing statement lapse date.<sup>7</sup>

A terminated financing statement remains active in the filing office records. It can be amended, assigned or even continued. If continued, the record will remain active for another five years. However, "active" does equal "effective." A record terminated with authorization is no longer effective to perfect the security interest, even though a search will continue to disclose it.

To properly interpret the record, a searcher should consider each termination as the opposite of a financing statement. A financing statement means nothing more than a security interest may cover the described collateral. A termination statement provides notice that the security interest may no longer exist. Just as with a financing statement, the searcher has a duty to inquire further to determine the effect.

Considering the size of the unauthorized termination problem, searchers ignore terminated financing statements at their own peril. The best practice for conducting a UCC search is to always request copies of terminated financing statements. A careful examination of unexpired, but terminated financing statements is an essential part of any reasonably diligent UCC search.

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### **Editor's Note:**

Mr. Hodnefield is Associate General Counsel of the Corporation Service Company (CSC), 380 Jackson Street, Suite 700, St. Paul, MN 55101, and has extensive experience in all aspects of secured transactions. He can be reached at 800-927-9801, ext. 2375; e-mail

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**Endnotes:**

<sup>1</sup> U.C.C. § 9-510(a) (1999) provides that “A filed record is only effective to the extent that it was filed by a person that may file it under Section § 9-508.” A person may file a termination under §9-509(d) only if the secured party of record authorizes the filing.

<sup>2</sup> Curiously, the name of the secured party that authorized the termination is not required. The lack of a name in Section 9 of the termination form is not a reason for rejection authorized by § 9-516(b). Still, the best practice is always to include this information.

<sup>3</sup> County real estate recording offices may require additional information to link a termination statement with the initial financing statement. For example, see § 9-516(b)(3)(D).

<sup>4</sup> Under certain circumstances described in § 9-513, § 9-509(d) provides that the debtor may authorize the filing of a termination statement.

<sup>5</sup> See generally *In re Summit Staffing Polk County, Inc.*, 305 B.R. 347, 355 (Bankr. M.D. Fla. 2003) (discussion of the searcher’s duty under Revised Article 9 to exercise reasonable diligence in examining search results).

<sup>6</sup> Official Comment to § 9-502.

<sup>7</sup> See § 9-522(a).

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## Remember the Carpenter Fund and the Normandin Fund For Your Year End Gifts

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Please be sure to remember the **M. Ellen Carpenter Fund** and the **Charles P. Normandin Fund** of the Boston Bar Foundation, when considering your year end charitable contributions. Contributions to these funds are a wonderful way to honor the memory of our colleagues, Ellen Carpenter and Charlie Normandin, while supporting the efforts of the Bankruptcy Section and the Boston Bar Association.

The **M. Ellen Carpenter Fund** was established in memory of M. Ellen Carpenter, who was an active member of the section and the first bankruptcy lawyer to serve as President of the BBA. The Fund supports the public service programs of the BBA that focus on mentoring young people and creating opportunities for their personal and professional enrichment. This year, for example, the Fund provided a stipend for a Boston high school student to intern at the Bankruptcy Court. Contributions to the Carpenter Fund may be sent to the Boston Bar Foundation, Attn: M. Ellen Carpenter Fund, P.O. Box 845680, Boston, MA 02284-5680.

The **Charles P. Normandin Fund** was established in honor of Charlie Normandin, an active member of the section and considered by many to be the “dean” of the bankruptcy bar. The Fund supports the pro bono, public service and civic programs founded or supported by the section. This year the Normandin Fund provided funding for the financial literacy and volunteer training programs of the Bankruptcy Section. Contributions to the Normandin Fund may be sent to the Boston Bar Foundation, Attn: Normandin Fund, P.O. Box 845680, Boston, MA 02284-5680.

For more information on either fund or the Boston Bar Foundation, please feel free to contact Georgia D. Katsoulomitis, BBF Managing Director, tel. 617-778-1948, e-mail: [GKatsoulomitis@bostonbar.org](mailto:GKatsoulomitis@bostonbar.org).

# Means Test Changes Looming

By **Bill McLeod, Esq.**

McLeod Law Offices, Boston

One of the key Bankruptcy Code changes brought on by BAPCPA – and probably the most debated by consumer attorneys – is the means test. Created to establish objective standards for abuse under § 707(b), many consumer attorneys will attest that it has added considerable time, attention and document review to case preparation. Last March, the Advisory Committee on Bankruptcy Rules approved changes that all consumer attorneys need to know about.

There are two important changes to the means test. The first is the form itself which will be used in cases filed on or after December 1. By press time, the forms were not available. However, Bankruptcy Judge Eugene Wedoff (Northern District of Illinois) presented the changes at the American Bankruptcy Institute's Northeast Consumer Forum held in Newport, RI in July.

The changes include additions to certain instruction provisions. Some are fairly straightforward, such as a change to Part I. Debtors who maintain that they not subject to § 707(b) because their debts are not "consumer debts" have argued they are not required to complete the form. However, they have also risked dismissal under § 521(a)(1) for not doing so. On the new form, Part I will have an expanded title ("Exclusions for Disabled Veterans and Non-Consumer Debtors" ) along with a new line and a check-box to allow debtors to attest that their debts are not primarily consumer debts for § 707(b) purposes.

The second change is the information used in applying the means test: the revised Collection Financial Standards and Allowable Living Expense figures issued by the IRS in October. These revised standards will apply to cases filed on or after January 1, 2008. For more details the revised standards, please visit the US Trustee Program/Department of Justice web site at [www.usdoj.gov/ust](http://www.usdoj.gov/ust).

Note the dates, and note the changes! For more information on these changes, as well as other important trends and issues facing the consumer bar, please join us on December 18, 2007 for a brown bag lunch program: "Dos and Don'ts in Consumer Bankruptcy." See Calendar of Section Events on page 3 for details about this program.

## QUOTATIONS (heard around the bankruptcy court)

"Why do you sit there looking like an envelope without any address on it?"

- Mark Twain

"He uses statistics as a drunken man uses lamp-posts...for support rather than illumination."

- Andrew Lang

"Even a stopped clock is right twice every day. After some years it can boast of a long series of successes."

- Marie Von Ebner-Eschenbach

"Maybe if we did a better job of listening, history wouldn't have to repeat itself."

- Somerset Maugham

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## Section Co-Chairs

Douglas B. Rosner, Esq.  
Goulston & Storrs  
400 Atlantic Avenue  
Boston, MA 02210  
(617) 574-6517  
drosner@goulstonstorrs.com

Donald R. Lassman, Esq.  
Law Office of Donald R. Lassman  
P.O. Box 920385  
Needham, MA 02492  
(781) 455-8400  
Don@Lassmanlaw.com

## Ad Hoc Committee New Bankruptcy Act

Peter N. Baylor, Esq.  
Nutter McClennen & Fish LLP  
World Trade Center West  
155 Seaport Boulevard  
Boston, MA 02210-2604  
(617) 439-2000  
pbaylor@nutter.com

Nina Parker, Esq.  
Parker & Associates  
10 Converse Place  
Winchester, MA 01890  
(781) 729-0005  
nparker@ninaparker.com

## Commercial Finance Committee (Joint with the Business Law Section)

Rafael Klotz, Esq.  
Goulston & Storrs  
400 Atlantic Avenue  
Boston, MA 02210  
(617) 482-1776  
rklotz@goulstonstorrs.com

Peter Palladino, Esq.  
Choate, Hall & Stewart LLP  
Two International Place  
Boston, MA 02110  
(617) 248-2132  
ppalladino@choate.com

## Consumer Bankruptcy Committee

Susan Grossberg, Esq.  
101 Tremont Street, Suite 1100  
Boston, MA 02108  
(617) 357-5555  
Grossberg@AA-Attorneys.com

William McLeod, Esq.  
McLeod Law Offices, PC  
77 Franklin Street  
Second Floor  
Boston MA 02110  
(617) 542-2956  
jm@mcleodlawoffices.com

## Financial Literacy Committee

Hon. Joan N. Feeney  
U.S. Bankruptcy Court, Room 1101  
Ten Causeway Street  
Boston, MA 02222  
(617) 565-6049  
Judge\_Joan\_Feeney@mab.us-  
courts.gov

Janet E. Bostwick, Esq.  
Janet E. Bostwick, PC  
295 Devonshire Street  
Boston, MA 02110  
(617) 956-2670  
jeb@bostwicklaw.com

## Law and Public Policy Committee

Michael Khoury, Esq.  
Madoff & Khoury LLP  
Suite 202  
124 Washington Street  
Foxborough, MA 02035  
(508) 543-0040  
khoury@mandkllp.com

Lee Harrington, Esq.  
Nixon Peabody LLP  
100 Summer Street  
Boston, MA 02110  
(617) 345-6016  
lharrington@nixonpeabody.com

## Membership Committee

Alex Mattera, Esq.  
Demeo & Associates, P.C.  
One Lewis Wharf  
Boston, MA 02110  
(617) 263-2600  
amattera@jdemeco.com

Peter Acton, Esq.  
McDermott Will & Emery  
28 State Street, 34th Floor  
Boston, MA 02109  
(617) 535-4412  
pacton@mwe.com

## Newsletter & Information Services Committee

Guy B. Moss, Esq.  
Riemer & Braunstein LLP  
Three Center Plaza, 6th Floor  
Boston, Massachusetts 02108  
(617) 880-3466  
gmoss@riemerlaw.com

John T. Morrier, Esq.  
Mintz, Levin, Cohn, Ferris, Glovsky  
and Popeo, P.C.  
One Financial Center  
Boston, MA 02111  
(617) 348-3051  
JMorrier@mintz.com

## Practice and Procedure Committee

Douglas Gooding, Esq.  
Choate, Hall & Stewart LLP  
Two International Place  
Boston, MA 02110  
(617) 248-5277  
dgooding@choate.com

Jesse Redlener, Esq.  
Nutter McClennen & Fish LLP  
World Trade Center West  
155 Seaport Boulevard  
Boston, MA 02210  
(617) 439-2813  
jredlener@nutter.com

## Pro Bono Committee

Mark Rossi, Esq.  
Altman Riley Esher LLP  
100 Franklin Street  
Boston, MA 02110  
(617) 399-7300  
rossi@Are-law.com

Adrienne Walker, Esq.  
Mintz Levin Cohn Ferris Glovsky  
and Popeo P.C.  
One Financial Center 41st Floor  
Boston, MA 02111  
(617) 348-1612  
awalker@mintz.com

## Young Lawyers Committee

Charles Azano, Esq.  
Mintz Levin Cohn Ferris Glovsky  
and Popeo P.C.  
One Financial Center  
Boston, MA 02111  
(617) 348-1843  
CWazano@mintz.com

Natalie Sawyer, Esq.  
Hanify & King, P.C.  
One Beacon Street, 21st Floor  
Boston, MA 02108  
(617) 423-0400  
nwb@hanify.com

## MEMBERS-AT-LARGE

Mitchel Appelbaum, Esq.  
Wilmer Cutler Pickering Hale and  
Dorr LLP  
60 State Street  
Boston, MA 02109  
(617) 526-6713  
mitchel.appelbaum@wilmerhale.  
com

Joseph H. Baldiga, Esq.  
Mirick, O'Connell, DeMallie &  
Lougee LLP  
100 Front Street  
Worcester, MA 01608  
(508) 791-8500  
jhbaldiga@mirickoconnell.com

Thomas O. Bean, Esq.  
McDermott Will & Emery, LLP  
28 State Street  
Boston, MA 02109  
(617) 535-4426  
bean@mwe.com

Mark N. Berman, Esq.  
Nixon Peabody LLP  
100 Summer Street  
Boston, MA 02110  
(617) 345-6037  
mberman@nixonpeabody.com

Ann Brennan, Esq.  
Stephen E. Shamban Law Offices,  
P.C.  
220 Forbes Road, Suite 208  
P.O. Box 850973  
Braintree, MA 02185  
(781) 849-1136  
abrennan@shambanlaw.com

Paul W. Carey, Esq.  
Mirick, O'Connell, DeMallie &  
Lougee LLP  
100 Front Street  
Worcester, MA 01608  
(508) 791-8500  
pwcarey@mirickoconnell.com

Charles A. Dale III, Esq.  
McCarter & English LLP  
265 Franklin Street  
Boston, MA 02110-2811  
(617) 449-6564  
cdale@mccarter.com

Christine E. Devine, Esq.  
Mirick, O'Connell, DeMallie &  
Lougee, LLP  
100 Front Street  
Worcester, MA 01608  
(508) 791-8500  
cedevine@mirickoconnell.com

Jennifer V. Doran, Esq.  
Hinckley, Allen & Snyder LLP  
28 State Street, 29th Floor  
Boston, MA 02109-1775  
(617) 378-4128  
jdoran@haslaw.com

Harry E. Ekblom, Jr., Esq.  
Sullivan & Worcester LLP  
One Post Office Square  
Boston, MA 02109  
(617) 338-2843  
hekblom@sandw.com

William J. Hanlon, Esq.  
Seyfarth Shaw LLP  
World Trade Center East  
Two Seaport Lane, Suite 300  
Boston, MA 02210-2028  
(617) 946-4995  
whanlon@seyfarth.com

Pamela A. Harbeson, Esq.  
Looney & Grossman LLP  
101 Arch Street  
Boston, MA 02110  
(617) 951-2800  
pharbeson@lgllp.com

Jennifer L. Hertz, Esq.  
Duane Morris LLP  
Suite 500  
470 Atlantic Avenue  
Boston, MA 02210  
(617) 289-9200  
jlhertz@duanemorris.com

Steven T. Hoort, Esq.  
Ropes & Gray LLP  
One International Place  
Boston, MA 02110-2624  
(617) 951-7470  
Steven.hoort@ropesgray.com

William W. Kannel, Esq.  
Mintz, Levin, Cohn, Ferris, Glovsky  
and Popeo, P.C.  
One Financial Center  
Boston, MA 02111  
(617) 542-6000  
bkannel@mintz.com

Richard L. Levine, Esq.  
Nelson Kinder Mosseau & Saturley,  
PC  
45 Milk Street, 7th Floor  
Boston, MA 02109  
(617) 778-7575  
rlevine@nkms.com

Christine D. Lynch, Esq.  
Goulston & Storrs  
400 Atlantic Avenue  
Boston, MA 02110-3333  
(617) 482-1776  
clynch@goulstonstorrs.com

Christopher R. Mirick, Esq.  
Cadwalader, Wickersham & Taft  
One World Financial Center  
New York, NY 10281  
(212) 504-6000  
christopher.mirick@cwt.com

Phoebe D. Morse, Esq.  
United States Trustee's Office  
Room 1184  
Ten Causeway Street  
Boston, MA 02222  
(617) 788-0440  
phoebe.morse@usdoj.gov

Colleen A. Murphy, Esq.  
Mintz, Levin, Cohn, Ferris, Glovsky  
and Popeo, P.C.  
One Financial Center  
Boston, MA 02111  
(617) 348-1836  
cmurphy@mintz.com

Christopher J. Panos, Esq.  
Craig and Macauley, P.C.  
Federal Reserve Plaza  
600 Atlantic Avenue  
Boston, MA 02110  
(617) 367-9500  
panos@craigmacauley.com

Michael J. Pappone, Esq.  
Goodwin Procter LLP  
Exchange Place  
Boston, MA 02109  
(617) 570-1940  
mpappone@goodwinprocter.com

Adam J. Ruttenberg, Esq.  
Looney & Grossman LLP  
101 Arch Street  
Boston, MA 02110  
(617) 235-8656  
aruttenberg@lglp.com

Bruce F. Smith, Esq.  
Jager Smith, P.C.  
One Financial Center  
Boston, MA 02111  
(617) 951-0500  
bsmith@jagersmith.com

David G. Sobol, Esq.  
Holland & Knight LLP  
10 St. James Avenue  
Boston, MA 02116  
(617) 305-2030  
david.sobol@hkllaw.com

Andrew P. Strehle, Esq.  
Brown Rudnick Berlack Israels LLP  
One Financial Center  
Boston, MA 02111  
(617) 856-8569  
astrehle@brbilaw.com

Anne J. White, Esq.  
Klieman, Lyons, Schindler & Gross  
21 Custom House Street  
Boston, MA 02110  
(617) 443-1000  
awhite@klsandg.com

## DO YOU KNOW YOUR ACRONYMS/ABBREVIATIONS? ANSWERS

**HEL** - Home Equity Loan

**DIM** - Deferred-Interest Mortgage

**URL** - Uniform Resource Locator

**WYSIWYG** - What You See Is What You Get

**HTML** - Hyper Text Mark-up Language

**HTTP** - Hyper Text Transfer Protocol

**MTV** - Music Television

**CSI** - Crime Scene Investigation

**ADT** - Average Daily Traffic

**LUI** - Land Use Intensity

**HVAC** - Heating, Ventilation, and Air Conditioning

**SM** - Service Mark