N O T E S O N

DEBTOR/CREDITOR

R E L A T I O N S

August 1998

Guaranty to Bank Voided

Certain types of commercial transactions may be undone in a bankruptcy case where the transaction falls within the definition of "fraudulent transfer". This definition covers many transactions where there is no actual intent to defraud creditors. Any transfer of the debtor's property for less than reasonably equivalent value while the debtor is insolvent may constitute a fraudulent transfer. In a recent case, a federal appeals court in Chicago examined the circumstances under which a cross-stream guaranty between sister corporations constituted a fraudulent transfer which may be voided in a bankruptcy case.

Both Corporation A and Corporation B were owned by the same sole shareholder. The bank made a loan to Corporation A which was guaranteed by Corporation B. None of the proceeds from the loan were received by Corporation B, even indirectly. Including the amount of the guaranty, Corporation B's liabilities exceeded its assets. Corporation B secured the guaranty by granting the bank a perfected security interest in all of Corporation B's assets. When Corporation B later commenced a bankruptcy case, Corporation B's trustee successfully challenged the guaranty and the bank's lien on Corporation B's assets as a fraudulent transfer.

In analyzing whether or not Corporation B received reasonably equivalent value for its guaranty of Corporation A's debt, the court examined whether Corporation B had received an indirect benefit which might have constituted reasonably equivalent value for the guaranty. The court suggested that "synergy" between the two corporations, such as safeguarding an important source of supply or an important customer, might provide indirect benefit sufficient to provide reasonably equivalent value for the guaranty. However, the court was unable to find any significant benefit to Corporation B from the guaranty of the loan to Corporation A and voided the guaranty and the bank's lien.

Leibowitz v. Parkway Bank (In re Image Worldwide, Ltd.), 139 F.3d 574 (7th Cir. 1998).

No GOB Sale in Bankruptcy

In a departure from numerous bankruptcy court decisions throughout the country, a Massachusetts bankruptcy court has held that a Chapter 11 debtor must comply with state laws regulating going out of business sales. The court rejected the arguments accepted by other courts that state laws restricting GOB sales could be set aside in order to maximize the recovery for creditors from the sale of the inventory of stores to be closed. The court reasoned that a federal statute required the Chapter 11 debtor to operate in accordance with state law, and no exception could be made merely to increase the amount of recovery for creditors.

In re Lauriat's, Inc. 219 B.R. 648 (Bankr. D. Mass. 1998).

This newsletter is intended to inform its readers of developments in the area of debtor/creditor relations. It is not legal advice or a legal opinion regarding any specific matter. You should consult a lawyer regarding any questions relating to your particular situation.

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