

DEBTOR/CREDITOR

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Bank Leaves Surety Empty Handed

A federal appeals court in Seattle was asked to decide which of two innocent parties would be left holding the bag when a construction contractor failed.

The bank provided a construction loan, requiring that the contractor maintain its accounts at the bank. The surety guaranteed payments to the suppliers with a bond. However, the contractor began to experience financial difficulties and fell behind on payments to its suppliers.

Four days after receiving a large progress payment from the project owner, which was wired directly to its bank account, the contractor declared itself in default of its construction contract, thereby shifting to the surety the burden of paying the suppliers. In order to compensate partially for the surety's payment of the suppliers, the contractor consented to the surety's receipt of any monies due the contractor. At the same time, the bank determined to set off the funds in the account against the outstanding loan obligations of the contractor. The surety later sued the bank for the funds.

While acknowledging that "the equities are strong, equally strong for both sides, so little is to be gained by arguing which deserves the money more," the court determined to leave the money where it was, in the hands of the bank.

Reliance Insurance Co. v. U.S. Bank of Washington, 143 F.3d 502 (9th Cir. 1998).

Title Insurer Punished

A federal district court in Kansas held a title company liable for refusing to issue a clean title policy to a bankruptcy trustee.

The property had been sold pursuant to an order of the

bankruptcy court free and clear of liens. When the title company refused to remove the exception for tax liens, the purchaser refused to consummate the transaction. The bankruptcy trustee successfully sued the title company for his lost profit on the sale, because the title company incorrectly refused to delete the tax lien exception in accordance with the court's order.

Morris v. Ford County Title Co. (In re Lisa, Inc.), 224 B.R. 173 (D. Kan. 1998).

No Discharge for Contractor

Many states, including Maryland, have construction trust fund statutes requiring contractors to hold in trust for payment to suppliers money received from the owners of the project. An Oklahoma bankruptcy court recently held that a contractor's failure to pay the trust funds to the suppliers as required by statute left the owner of the corporate contractor personally liable to the suppliers. The court further determined that this misapplication of the trust funds constituted fraud or defalcation while acting in a fiduciary capacity, which was not discharged in a bankruptcy case.

Spectrum Paint Co. v. Chambers (In re Chambers), 226 B.R. 915 (Bankr. N.D. Okla. 1998).

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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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