

DEBTOR/CREDITOR

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Earmarking Doctrine Inapplicable

The bankruptcy law allows a debtor or trustee to recover certain payments made to creditors during the 90 days prior to the bankruptcy filing as preferential transfers. However, if the debtor made the payment with new funds received for the purpose of paying a particular creditor, the payment will not be considered preferential, because the funds were "earmarked" for this particular creditor.

A bankruptcy appellate panel recently explained the parameters of the earmarking doctrine. The doctrine requires (1) an agreement between the new lender and the debtor that the new funds will be used to pay a specific existing debt, and (2) no diminution of the debtor's total estate as a result of the transaction.

The debtor before the court had paid premiums to its insurer with a loan from a special working capital fund provided by investors. The transaction merely exchanged debt to the insurer for debt to the working capital fund. However, the court found that the earmarking doctrine did not apply, because the debtor decided which bills to pay. *Gray v. Travelers Insur. Co. (In re Neponset River Paper Co.)*, 231 B.R. 829 (Bankr. 1st Cir. 1999).

Bankruptcy Cuts Off IRS Lien

A federal appeals court in Richmond recently resolved a conflict between bankruptcy law and tax law regarding the reach of an IRS tax lien. Normally, a tax lien attaches to any property that the taxpayer acquires after the IRS has filed its notice of lien. However, the automatic stay provided under the federal bankruptcy statute prohibits any acts to create a lien against property of the debtor.

The court decided that a federal tax lien recorded prior to commencement of the bankruptcy case does not attach

to property acquired by the debtor after the bankruptcy petition is filed. However, the tax lien may attach to a portion of the property acquired post-petition where the property's receipt was previously expected subject to contingencies, as in the case of a bequest. The lien attaches to the present value of the debtor's future interest determined as of the date the petition is filed.

United States v. Gold (In re Avis), 1999 U.S. App. LEXIS 14217 (4th Cir. June 28, 1999).

Security Interest Defeated

A freight forwarder invoiced its customer with preprinted invoices that gave the freight forwarder a security interest in all of the customer's goods in transit. In its bankruptcy case, the customer objected to the freight forwarder's secured claim. A federal appeals court in San Francisco ruled that the preprinted invoice terms did not create a security interest in the customer's property. The court reasoned that acceptance without protest of the preprinted invoices did not itself establish that the debtor intended to provide its goods in transit as collateral. *Expeditors Int'l v. Creditors Committee (In re CFLC, Inc.)*, 166 F.3d 1012 (9th Cir. 1999).

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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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