N O T E S O N

DEBTOR/CREDITOR

R E L A T I O N S

February 2000

Bankruptcy Trustee Owned Successor Liability Claim

The legal form of the modern corporation was created in the 19th century to shield shareholders from personal liability for corporate debts. Only the corporation is liable for its debts. However, in order to counter abuses, the courts developed the doctrine of successor liability. Where the assets and business of a corporation are transferred to another entity, creditors of the old corporation may sue the new entity, as successor, to recover their claims.

A federal appeals court in Richmond has decided that a bankruptcy filing by the first corporation eliminates the ability of creditors to sue the new entity under a successor liability theory. Only the bankruptcy trustee may pursue successor liability claims against the new entity. This liability can be limited to the value of the assets transferred.

Small business owners that move the business to a new entity when financial problems arise should consider whether bankruptcy would be appropriate to prevent creditors from pursuing the new company.
National American Insurance Co. v. Ruppert Landscaping Co., 187 F.3d 439 (4th Cir. 1999).

How soon is "Prompt"?

The bankruptcy law permits a Chapter 11 debtor to "assume" or "reject" its leases. If the debtor chooses to assume a lease, the statute requires the debtor to cure or provide adequate assurance that it will promptly cure any defaults under the lease.

A Texas bankruptcy court was asked to determine whether a debtor's proposal to cure defaults over six months was sufficiently prompt to satisfy the statue. The court found six months to be reasonably prompt when compared with the 42 months remaining under the lease, but reduced the cure period to four months, explaining: "[I]t is appropriate for the Debtor's principals to engage in some degree of sacrifice in order to eliminate the outstanding deficits owing to [landlord] in the most expeditious manner possible."
In re PRK Enterprises, Inc., 235 B.R. 597 (Bankr. E.D. Tex. 1999).

Collateral Returned to Borrower

Automobile purchasers who do not make payments to the finance company commonly have their cars repossessed. This often triggers a bankruptcy, where the automatic stay prevents the finance company from selling the collateral at auction.

A federal district court in Texas recently decided that the stay not only prevents the creditor from taking further action with the respect to the collateral, but also requires the creditor to return the collateral to the debtor. The court sanctioned the finance company for failing to return the vehicle.

The Texas court's ruling requires secured creditors to take prompt action to obtain relief from the automatic stay.
Nissan Motor Acceptance Corp. v. Baker, 239 B.R. 484 (N.D. Tex. 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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