N O T E S O N

DEBTOR/CREDITOR

R E L A T I O N S

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Indemnification Discharged

As illustrated by a recent case from a federal appeals court in New York, a debtor may discharge its contingent obligation to indemnify another party, even where the demand for indemnification does not occur until many years after the bankruptcy.

Olin Corporation spun off its forest products division in 1967. As part of the spin off, the new company agreed to indemnify Olin for any liabilities arising from the activities of the forest product division. Manville Forest Products Corporation acquired the new company in 1979. Manville filed a Chapter 11 petition in 1982, and its plan was confirmed in 1984. The plan discharged Manville from all debts arising prior to the date of confirmation.

In 1996, the Louisiana Department of Environmental Quality demanded that Olin clean up Plant 94, one of the assets that was spun off and eventually acquired by Manville. Olin sought indemnification from Manville under the original indemnification agreement.

The federal appeals court held that the contingent liability under the indemnification agreement had been discharged in 1984, because the acts which gave rise to the environmental liability had occurred prior to the bankruptcy, even though the liability asserted by the State of Louisiana first materialized many years later.

Creditors receiving notice of a bankruptcy filing should be aware that even contingent claims may be discharged and should include such contingent claims when filing a proof of claim in the case.

Olin Corp. v. Riverwood International Corp. (In re Manville Forest Products Corp.), 209 F.3d 125 (2d Cir. 2000).

After-Acquired Property Clause Enforced

Lender security agreements usually include language granting a security interest not only in property of the borrower that exists at the time of the loan, but also in any property acquired by the borrower subsequently. The Bankruptcy Code cuts off the effect of this after-acquired property clause regarding any property which the debtor obtains after the filing of the bankruptcy, unless that property is "proceeds" of secured property owned before the bankruptcy filing.

Pat and Traci Norville, family farmers, had a bad year in 1998. In May 1999, they filed for bankruptcy protection. Shortly thereafter, they filed a claim under the Federal Crop Loss Disaster Assistance Program. They later received a check in the amount of $16,176.

However, the Norvilles' fortunes continued to worsen. Their bank sought to compel turnover of FCLDA payment, arguing that the payment was collateral under the bank's security agreement. The debtors countered that the after-acquired property clause in the security agreement was not effective with regard to the FCLDA payment received after the bankruptcy.

The Illinois bankruptcy court sided with the lender, reasoning that the crop loss and the right to receive the payment predated the bankruptcy. The lender's security interest had attached at that time, even though the actual application for payment did not take place until after the bankruptcy.

Mercantile Bank v. Norville (In re Norville), 248 B.R. 127 (Bankr. C.D. Ill. 2000).

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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.

Prepared by James C. Olson, Attorney and Counselor at Law

One Corporate Center Suite 400 10451 Mill Run Circle Owings Mills, MD 21117 410-356-8852 Fax 410-356-8804 jolson@jamesolsonattorney.com