N O T E S O N

DEBTOR/CREDITOR

R E L A T I O N S

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Stealth Lien Removal

A Baltimore bankruptcy court recently decided that the bankruptcy law eliminates liens on property automatically, without a specific request by the Chapter 11 debtor.

The federal bankruptcy statute states that when the court confirms a debtor's Chapter 11 plan, "the property dealt with by the plan is free and clear of all claims and interests of creditors." The plan in the case before the court made no mention of a secured creditor's lien claim. However, the plan provided that the collateral was to be sold and the proceeds divided among creditors as set forth in the plan.

After confirmation of the plan and sale of the collateral, the secured creditor objected to receiving only a pro rata distribution from the proceeds of its collateral, arguing that its lien on the collateral remained absent a specific proceeding by the debtor to void the lien. The court rejected this view, holding that the bankruptcy statute itself automatically eliminated the lien on the collateral unless the plan explicitly maintained the lien.

Because a Chapter 11 plan may eliminate lien rights merely by silence, creditors must be vigilant to ensure that any plan affirmatively protects their rights and interests.
In re Regional Building Systems, Inc., 251 B.R. 274 (Bankr. D.Md. 2000)

Notice of Lien Insufficient

A secured creditor that wishes its lien to survive bankruptcy must comply with all requirements of the Uniform Commercial Code in the creation/perfection of the lien. Absent a written security agreement, filing a notice of the lien in the public record leaves the creditor with nothing.

In a New York bankruptcy case, the secured lender had sought to perfect a lien on the debtor's vehicle. The lender required the debtor to sign a promissory note and filed the required notice of lien with the Department of Motor Vehicles. However, the court found the failure to sign a written security agreement fatal to the secured claim in the bankruptcy case.
Morin v. Galan (In re Lanzatella), 254 B.R. 84 (Bankr. W.D.N.Y. 2000).

Embezzlement Not Discharged

When an individual files a Chapter 7 bankruptcy case, certain types of debts are not discharged. Among those not discharged is any debt from fraud or embezzlement by the debtor. However, if the embezzling debtor settles before bankruptcy with the party from whom he embezzled, that debt for embezzlement is replaced by a simple contract debt under the settlement agreement. Contract debts are generally discharged.

Last year, an Ohio bankruptcy court sided with the majority of other courts that have considered the matter, determining that the settlement agreement in such a case continues to be a debt for embezzlement and is not discharged in the Chapter 7 bankruptcy case.
Houston v. Cantrill (In re Cantrill), 247 B.R. 429 (Bankr. N.D. Ohio 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.

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