N O T E S O N

DEBTOR/CREDITOR

R E L A T I O N S

April 2001

Change of Address

Each of you should have received an announcement of my office relocation in the mail. If you did not, please update your records to reflect my new address and telephone number printed at the bottom of this page.

Diversion of Construction Trust Funds

Under Maryland statutes, construction contractors that receive payment from an owner of property hold the money received in trust for the benefit of subcontractors and suppliers who performed work or provided materials for the project. The statute goes further and creates personal liability to "any officer, director, or managing agent" that knowingly diverts trust funds for use other than payment of a subcontractor or vender.

A Baltimore bankruptcy judge recently affirmed the applicability in a bankruptcy case of the personal liability imposed on responsible corporate officers. Thus, if the corporation's financial woes force the principals to file individual bankruptcy cases, claims against the corporation for diversion of trust funds will also be claims in the individual cases.
In re McGee, 258 B.R. 139 (Bankr. D.Md. 2001).

Future Rent Capped

The federal bankruptcy statute limits the damages that a landlord may claim for termination of a lease to one year's future rent, in most cases. This permits a tenant in Chapter 11 to vacate unnecessary leased space without creating large liabilities for the many years which may remain on a lease. The courts have previously expanded the reach of this rent cap to cover landlord claims against guarantors of a lease.

Last December, a Florida bankruptcy judge further expanded the reach by concluding that the rent cap applies not only to landlords, but also to a former tenant who had assigned the lease. Sometime after the first tenant assigned its lease, the assignee commenced a Chapter 11 case. The assignor/ former tenant remained liable to the landlord and filed a claim in the bankruptcy case seeking the full amount of rent due under the lease. The court decided that the limitation on landlords should be equally applicable to the assignor in this case.
In re Southern Cinemas, Inc, 256 B.R. 520 (Bankr. M.D.Fla. 2000).

Non-Competition Clause Survives

The federal bankruptcy law permits debtors to "reject" contracts that are burdensome. The damages to the other party flowing from this rejection are merely claims against the bankruptcy estate, to be paid only a percentage of the actual amount. Not everything in a contract may be rejected, however.

At the end of last year, a federal district judge in Massachusetts joined other courts in deciding that a non-competition clause in a franchise agreement survives and may be enforced through an injunction by the other party even after the agreement is rejected in a bankruptcy case.
Sir Speedy, Inc. v. Morse, 256 B.R. 657 (D.Mass. 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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