N O T E S O N

DEBTOR/CREDITOR

R E L A T I O N S

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Corporate Officers Liable

Two recent cases highlight areas where even bankruptcy cannot discharge a corporate officer's personal obligation to pay a corporate debt.

In the first case, an agreement between a travel agency and an airline required the agency to deposit ticket sale proceeds into a trust account. A corporate officer personally guaranteed the agency's performance of this agreement. The corporation failed to make the deposits into the trust account.

A federal appeals court in Richmond determined that the bankruptcy of the individual officer did not discharge him from his guarantee to the airline, because the officer's failure to cause the corporation to make the deposits into the trust account was a defalcation while acting in a fiduciary capacity.

Airlines Reporting Corp. v. Ellison (In re Ellison), 296 F.3d 266 (4th Cir. 2002).

In the second case, a small construction company owned by two individuals was required by its collective bargaining agreement to make certain contributions to a multi-employer pension fund set up by the employees' union pursuant to the Employee Retirement Income Security Act. While the corporation was failing, it ceased making pension fund contributions. The two owners filed bankruptcy petitions.

The Arkansas bankruptcy judge determined that the two owners were personally liable for the unpaid corporate pension contribution and that this liability could not be discharged. The Court reasoned that the provisions of the ERISA made the funds of the corporation assets of the pension fund. The two corporate officers therefore controlled pension fund assets. Failure to turn over the assets (the corporate contribution) to the pension fund was a defalcation while acting in a fiduciary capacity.

Hunter v. Philpott (In re Philpott), 281 B.R. 271 (Bankr. W.D. Ark. 2002).

Bankruptcy Beats Good Faith Defense

As enacted in each state, the Uniform Commercial Code may require filing of a financing statement in one or more locations in order to perfect a security interest. Failure to file in the correct location(s) could leave the secured creditor unperfected, unless a mistake was due to good faith reliance on information provided by the borrower. However, the outcome may be different in a bankruptcy case.

An equipment lender in Arkansas erroneously filed the financing statement in the wrong county, because the borrower's application listed the wrong address. In a suit by the bankruptcy trustee to void the security interest, the lender raised as a defense its good faith reliance on the information provided by the debtor. The bankruptcy judge rejected this defense, explaining that the trustee's powers were not subject to representations made by the debtor.

Lenders would be well advised to seek independent verification of a borrower's representations.

Wetzell v. Equipment Dealers Credit Co. (In re Davis), 274 B.R. 825 (Bankr. W.D. Ark. 2002).

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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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