

DEBTOR/CREDITOR

April 2003

Fraud Not Discharged

Under the bankruptcy statute, claims arising from a debtor's fraud normally may not be discharged. Claims arising from breach of contract may be discharged. What is the result where a lawsuit seeking recovery for fraud is settled, thereby converting the fraud claim into a contract claim under the settlement agreement? Appellate courts have been divided as to whether the nondischargeable status of the fraud claim applies to the new contract claim.

In April 2002, I noted the decision of the United States Court of Appeals for the Fourth Circuit in *Archer v. Warner*, which ruled that (1) the settlement extinguishes the fraud claim and (2) the contract claim under the settlement agreement can be discharged in a subsequent bankruptcy.

The United States Supreme Court reversed that decision last month, resolving the division among the lower courts. A plaintiff may now settle a fraud claim without fear that the defendant's subsequent bankruptcy will discharge the amount due under the settlement agreement.

Archer v. Warner, 2003 U.S. LEXIS 2498 (Mar. 31, 2003).

Creditor Sanctioned for Tardy Dismissal

In a common scenario, a creditor hires a collection agency when invoices remain unpaid. After sending a demand letter, the collection agency files a lawsuit, not knowing that the debtor has filed a bankruptcy petition. The commencement of the legal action is a violation of the automatic stay provisions of the federal bankruptcy statute, albeit an unknowing violation.

Once the creditor is informed of the pending bankruptcy, the creditor has an affirmative duty to correct the unwitting stay violation by dismissing the lawsuit. A federal appeals court recently approved a \$1,000 sanction against a collection attorney for waiting 23 days after notification of the bankruptcy stay to dismiss the lawsuit.

A word to the wise....

Eskanos & Adler, P.C. v. Leetien, 309 F.2d 1210 (9th Cir. 2002).

Right of First Refusal Eliminated

A Chapter 11 debtor may "reject" an executory contract, thereby relieving the debtor from the obligation to continue performing the contract. Contracts are executory if both parties still have unperformed obligations. Even contracts that are executory may contain provisions that are non-executory and by which the debtor will continue to be bound after rejection. For example, non-compete clauses generally remain enforceable against a debtor even after rejection of the rest of an agreement.

A right of first refusal in a contract gives the holder of the right the ability to purchase property at the price offered by another purchaser. The holder of the right does not have to top the other offer. Bankruptcy courts are divided as to whether a right of first refusal can be rejected, freeing the debtor to sell the property to any purchaser.

Last November, a Delaware bankruptcy judge joined the majority of courts in determining that a provision granting a right of first refusal is executory and may be rejected by a debtor. This result allows a Chapter 11 debtor to obtain greater value from sale of the property.

In re Kellstrom Industries, 286 B.R. 833 (Bankr. D. Del. 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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