N O T E S O N

DEBTOR/CREDITOR

R E L A T I O N S

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Escrow Remains Outside Bankruptcy

Escrow agreements can be used to avoid the reach of the automatic stay of a bankruptcy case. In a recent example, as part of a workout agreement, the lender required the borrower to place into escrow the borrower's ownership interest in Concourse Communications. By the terms of the escrow agreement, if the borrower defaulted on its obligations, the escrow agent was to deliver the ownership interest to the lender.

After defaulting under the workout agreement, the borrower filed a Chapter 11 petition. A federal appeals court in Boston determined that the property in escrow was no longer the property of the borrower/debtor, and the transfer to the lender was not subject to the automatic stay.

Both institutional lenders and trade creditors should consider whether the use of an escrow arrangement is advisable when dealing with a financially troubled customer. *NTA, LLC v. Concourse Holding Company (In re NTA, LLC), 380 F.3d 523 (1st Cir. 2004).*

Preference Defense Succeeds

Under the federal bankruptcy statute, trustees may recover certain payments made within ninety days prior to commencement of the bankruptcy case as preferential transfers. The statute also provides several affirmative defenses, of which the "new value" and "ordinary course" are used most frequently.

A Missouri bankruptcy case illustrates one of the less-used defenses -- "substantially contemporaneous exchange". The debtor was a retailer of home improvement products. The debtor and a supplier agreed that the debtor would pay invoices within 12 days when shipment was by rail and within 3 days when shipment was by truck. In this manner, payment would be received by the supplier on or before the date the goods were actually received by the debtor. Because the date of payment was selected to match approximately the date of delivery, the court held that the payments were a contemporaneous exchange, which could not be recovered by the trustee.
Silverman Consulting, Inc. v. Canfor Wood Products Marketing (In re Payless Cashways, Inc.), 306 B.R. 243 (Bankr. 8th Cir. 2004).

Creditor Enforces Automatic Stay

The automatic stay is a significant debtor protection. The federal bankruptcy statute provides that an individual injured by a willful violation of the stay may recover damages. A Maryland bankruptcy court has expanded this protection to allow a corporate creditor to recover damages from another creditor for violation of the stay.

A consumer filed a Chapter 7 case and indicated her intent to surrender her car to the finance company holding a lien on the vehicle. However, instead, a repair shop foreclosed its mechanic's lien for unpaid repair charges by selling the vehicle. The finance company sought damages from the repair shop for the sale of the vehicle in violation of the automatic stay. The court determined that the stay was intended to protect creditors as well as debtors and permitted the finance company to go forward against the repair shop. *Ford Motor Credit Co. v. Hemsley (In re Bennett), 317 B.R. 313 (Bankr. D. Md. 2004).*

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