NOTES ON

DEBTOR/CREDITOR

RELATIONS

April 2005

Pension Benefits Lost

The federal bankruptcy statute permits a court to reverse a fraudulent transfer. This means a transfer of property by an insolvent debtor who receives in exchange something of less than reasonably equivalent value. Actual fraudulent intent is not required. Recently, a Delaware court considered whether a pension plan amendment may be a fraudulent transfer.

In an attempt to trim expenses, the debtor froze its retirement benefits in 1991 at each participant's current salary level. Five years later, the board of directors amended the pension plan to provide certain management employees with additional contributions to their pension accounts. The effect of this change was to increase the pension plan's liability by 2.4 million dollars. No additional company contribution was required, because the pension plan was over-funded. Within three weeks, the company filed a Chapter 11 petition.

The court found the plan amendment to be a fraudulent transfer. Even though the pension assets were not property of the debtor, the court reasoned that the insolvent debtor would have received the 2.4 million dollars from the pension plan when the plan eventually terminated, thereby giving the debtor an interest in the property transferred. The court also held that the irrevocable election to increase the pension benefits was a transfer, even though no funds changed hands at that time. Moreover, the court found no evidence that the increase in pension benefits helped the debtor retain any key employees, which might have provided reasonably equivalent value for the additional pension benefits. *Pension Transfer Corp. v. Beneficiaries,* 319 B.R. 76 (D. Del. 2005).

Bank Setoff Avoided

Banks have a common law right to set off funds deposited by a customer against a loan to that customer, if the loan is in default. However, an Arizona bankruptcy court has permitted a bankruptcy trustee to recover a setoff from a bank where the bank failed to follow the customer's direction.

The debtors had several loans with the bank, some of which were secured by real estate and some of which were unsecured. Shortly before filing a bankruptcy petition, the debtors deposited $25,000 in their checking account and instructed the bank to apply it to several outstanding secured loans. The bank initially applied the funds in the checking account in accordance with the debtors' instructions. However, one week later, the bank reversed these transactions and set off the funds against unsecured loans.

After the debtors filed their Chapter 7 bankruptcy case, the trustee commenced an action against the bank to reverse the setoffs as preferential transfers and recover the monies for other creditors. The court agreed, holding that the customer's direction as to how to apply the deposit prevented the bank from exercising its setoff rights. While a proper setoff would have been immune from recovery as a preference, the trustee could recover this improper setoff. *Davis v. Wells Fargo & Co. (In re Haynes),* 309 B.R. 577 (Bankr. D. Ariz. 2004).

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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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