

DEBTOR/CREDITOR

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States May Be Sued

As a general matter, state governments and their agencies may not be sued without their consent. This rule is referred to as “sovereign immunity”. The state’s sovereign immunity is specifically protected by the Eleventh Amendment to the United States Constitution. However, the United States Supreme Court recently held that the states gave up their sovereign immunity from suits arising under the bankruptcy laws.

The trustee of a bankrupt bookstore sued a state college to recover a preferential transfer. The state claimed immunity from the suit. The Court found that the ability to recover preferences was a specific bankruptcy power from which the states were not immune. Prior to this ruling, most courts prohibited direct suits to recover money from state agencies under the bankruptcy law.

It is not clear whether the Court’s holding should be restricted to suits to recover preferences and fraudulent transfers, each of which is a traditional bankruptcy theory of recovery. The Court’s language is broad enough to permit suits based on any legal theory which would provide recovery of assets in a bankruptcy case.

Central Virginia Community College v. Katz, 126 S. Ct. 990 (2006).

Specific Performance Not Rejected

The federal bankruptcy statute permits a debtor to reject a contract that is not yet fully performed. The other party to the contract receives an unsecured claim for damages from the breach caused by the rejection. However, certain contract provisions survive rejection.

A restaurant tenant acquired a liquor license from its landlord. The contract required the tenant to transfer the liquor license back to the landlord at termination of the

lease. The tenant filed a bankruptcy and rejected the lease, seeking to keep the liquor license and sell it. The landlord objected and sought to compel the tenant to return the liquor license in compliance with the now rejected contract. A bankruptcy appellate panel in Massachusetts sided with the landlord, finding that rejection did not terminate the landlord’s right to specific performance of the obligation to transfer the liquor license.

Abboud v. Ground Round, Inc. (In re Ground Round, Inc.), 335 B. R. 253 (Bankr. 1st Cir. 2005).

Spendthrift Trust Trumps Bankruptcy

A Chapter 7 bankruptcy trustee sought to obtain possession of monies in a trust set up by a debtor’s father for benefit of the debtor. The trust agreement contained a clause prohibiting creditors of the beneficiary from reaching the trust assets to satisfy the beneficiary’s debts. However, the trust agreement permitted the trust to pay these debts voluntarily.

The Ohio bankruptcy court determined that the trust assets were outside the reach of creditors, including the bankruptcy trustee, even though the trust had discretion to voluntarily pay the creditor claims. Because the trust had not done so, the bankruptcy law did not permit the bankruptcy trustee to force payment. *In re Eley*, 331 B. R. 353 (Bankr. S. D. Ohio 2005).

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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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