

DEBTOR/CREDITOR

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Mortgage Voided as Preference

The federal bankruptcy statute gives a bankruptcy trustee the ability to reverse and recover certain transfers of a debtor's property made within 90 days prior to commencement of the bankruptcy case. The reversible transfers are called "preferences". The most common type of preference is a debtor's payment to a creditor within 90 days before the bankruptcy. However, creation of a lien on property is also a transfer which can be reversed if it is preferential.

A lien or security interest that is recorded within 90 days before a bankruptcy filing is not a preference, if the recordation is less than 30 days after the loan. A Massachusetts bank learned this the hard way when a bankruptcy trustee voided its mortgage on the debtor's house, because the bank waited too long after the loan to record. The bank was left an unsecured creditor.

The moral for creditors: Record security documents immediately after closing the loan.

Collins v. Greater Atlantic Mortgage Corp. (In re Lazarus), 478 F.2d 12 (1st Cir. 2007).

Creditor Loses Interest

In order to prevent a high interest rate from improving one creditor's position relative to other creditors during a bankruptcy case, unsecured claims do not accrue interest against a debtor after commencement of the bankruptcy case. However, interest will continue to accrue against non-debtor guarantors.

A non-debtor guarantor paid the entire principal amount of a debtor's loan after the bankruptcy filing. In accordance with the loan documents, the creditor applied the payment first to interest and then to reduction of principal. As a result, the amount of principal remaining due was exactly

equal to the amount of interest which had accrued after the bankruptcy filing. A divided appeals court ruled that the guarantor's payment eliminated the creditor's claim against the debtor entirely, because to do otherwise would have the practical effect of permitting the post-bankruptcy interest to accrue against the debtor also.

National Energy & Gas Transmission, Inc. v. Liberty Electric Power, LLC (In re National Energy & Gas Transmission, Inc.), 2007 U.S. App. LEXIS 16263 (4th Cir. July 10, 2007).

Rent Capped

Commercial leases generally leave the tenant liable to pay rent for the entire term of the lease, even if the tenant vacates the premises early. However, the bankruptcy statute limits the future rent that a landlord can claim. In most cases, the claim for future rent is capped at one year.

An Ohio bankruptcy court recently decided that this rent cap applies even where the landlord obtained a judgment for the full amount of the rent prior to the bankruptcy filing.

The moral for debtors: It is never too late to seek bankruptcy protection.

In re ProCare Automotive Service Solutions, LLC, 359 B.R. 653 (Bankr. N.D. Ohio 2007).

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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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