N O T E S O N

DEBTOR/CREDITOR

R E L A T I O N S

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When Is a Lease Really a Sale?

Courts are not required to accept the label that parties attach to a transaction. For example, both bankruptcy law and the Uniform Commercial Code permit courts to recharacterize an equipment lease as a sale of equipment. Recasting the lease as a sale reduces the lessor's rights in a bankruptcy case.

A Texas bankruptcy court concluded that a "lease" of oil drilling rigs was really a sale, with the lessor retaining a security interest. Among the indicia supporting recharacterization, the court mentioned: (1) the purchase option price at the conclusion of the lease was so low that the lessee would undoubtedly exercise it; (2) the lessor had made no plans for return of the equipment; and (3) the total amount of the lease payments was equal to the full price of the equipment plus an interest charge over the term of the "lease". Because it was clear that the lessor expected nothing back at the conclusion of the lease, the court treated the transaction as a sale.

In re Ecco Drilling Co., Ltd., 390 B.R. 221 (Bankr. E.D. Tex. 2008).

No Duty to File Bankruptcy Petition

Corporate officers and directors owe fiduciary duties to shareholders. However, when a corporation becomes insolvent, the creditors become beneficiaries of these duties.

The bankruptcy trustee of a corporation sued the officers and directors, alleging that they breached their fiduciary duties to creditors by failing to file a bankruptcy sooner. The trustee claimed that the officers kept the company operating during the year prior to bankruptcy and continued to pay themselves while deepening the insolvency of the corporation.

In ruling against the trustee, a Minnesota bankruptcy court held that the officers' and directors' duty during insolvency was not exclusively to the creditors, but also to the shareholders. Immediate liquidation would only be required where there was no reasonable future business prospect. Because the court found directors had a reasonably based hope of a turnaround, delay in liquidation did not breach any fiduciary duty.

Hedback v. Tenney (In re Security Asset Capital Corp.), 396 B.R. 35 (Bankr. D. Minn. 2008).

Creditor Acts for Trustee

Where the federal bankruptcy statute gives a bankruptcy trustee the right to sue a third party, may a creditor sue in place of the trustee on behalf of the bankruptcy estate? The answer to this question is of practical importance in cases where a bankruptcy trustee is either unwilling or unable to pursue claims against third parties. Frequently, the trustee does not have the resources to fund the litigation necessary to recover on the claim.

A federal appeals court recently ruled that the ability to sue on the claim is not exclusive to the trustee. A creditor may obtain permission from the bankruptcy court to pursue a claim on behalf of the bankruptcy estate in place of the trustee, where it is in the best interest of all creditors to do so. If the creditor is successful, the cost of the litigation will be paid from the bankruptcy estate.

Hyundai Translead, Inc. v. Jackson Truck & Trailer Repair, Inc., 555 F.3d 231 (6th Cir. 2009).

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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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