NOTES ON

DEBTOR/CREDITOR

RELATIONS

January 2011

Stock Appreciation Rights Lost

As an incentive to employees, Spirit AeroSystems created an equity participation program ("EPP") to which it agreed to contribute stock appreciation rights ("SARs") if an initial public offering ("IPO") occurred in the future. After Spirit agreed to set up the program, but before it had done so, an employee filed a Chapter 7 bankruptcy case. One year later, the company formally set up the EPP. Shortly thereafter, the company completed an IPO and distributed SARs to its employees worth $61,440 per employee.

The employee's bankruptcy trustee claimed the SAR, arguing that the SAR was property of the employee prior to bankruptcy filing. The employee argued that the SAR was not the trustee's, because the creation of the EPP and the IPO all occurred after bankruptcy. A federal appeals court sided with the trustee, holding that the right to receive the SAR was sufficiently related to the events before the bankruptcy to make the SAR property the bankruptcy estate.
Parks v. Dittmar (In re Ditmar), 618 F.3d 1199 (10th Cir. 2010).

Bank Loses Right to Credit Bid

If a Chapter 11 debtor seeks to sell property, the sale is subject to higher offers. This means that all bankruptcy sales have the potential to become auctions, should another purchaser make a higher offer. If the property is encumbered by a mortgage or security interest, the secured lender will receive the proceeds of the sale up to the amount of the debt. In order to protect the secured lender from low-ball offers, the bankruptcy statute permits the lender to bid with its debt (a "credit bid"). This gives the lender the option to acquire the property itself, if the lender feels that the other bids are less than the true value of the property.

A federal appeals court in Philadelphia recently ruled that this protection for the lender does not apply in certain contexts. The court decided that a Chapter 11 debtor can sell secured property under a plan of reorganization without allowing a lender to credit bid.

Because it is extremely unusual for a lender to bid actual money to acquire secured property ("throwing good money after bad"), the absence of a right to credit bid would allow a friendly purchaser to acquire the property without having to compete with the bank.
In re Philadelphia Newspapers, LLC, 599 F.3d 298 (3d Cir. 2010).

Breach of Contract Not Discharged

A recent case shows a willingness of bankruptcy judges to treat breaches of contract as intentional injuries, which are not discharged in bankruptcy.

In one case, a farmer borrowed $100,000 to pay for the operation of his farm until the harvest. The loan was secured by his crops. When he harvested and sold the crops, the farmer did not pay the proceeds to the lender, as required by the loan documents, but used the proceeds for his own expenses. The court held that this knowing breach of the loan agreement prevented the farmer from discharging his debt to the lender.
Farm Credit Services v. Marklin (In re Marklin), 429 B.R. 880 (Bankr. W.D. Ky 2010).

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