MARKS & WEINBERG, P.C.

Cardinal Fastener & Specialty Co. v. Progress Bank

2003 U.S. App LEXIS 11867

Occasionally, lessors will take a security interest in the stock, membership interest or other ownership interests of the lessee. There are many issues regarding this sort of security interest and the rules governing how to "perfect" a lessor's rights in such ownership interests are complex and full of pitfalls. In addition to the complexity and resulting legal expenses necessary to properly evidence a lessor's lien on such ownership interest, there are other risks involved.

This case provides a nice example of the risk of successor liability. Progress Bank ("Progress") was a fully secured lender to Allied Nut & Bolt Company ("Debtor"). Cardinal Fastener ("Cardinal") was an unsecured creditor with a practically worthless default judgment against Debtor. Debtor's financial problems were severe and Debtor surrendered its assets to Progress who took over management of Debtor's business and began the process of liquidating it.

Cardinal, who received nothing during the liquidation, sued Progress, alleging that Progress was liable for Debtor's obligations under a variety of theories, including theories of corporate successor liability and lender control liability. The idea was that Progress was the corporate successor of Debtor and therefore became liable for monies Debtor owed to Cardinal.

Fortunately for Progress and for secured lenders, generally, the Circuit Court rejected Cardinal's argument and held that Progress did not attempt to merge its banking business with Debtor's in an effort to continue manufacturing screws, nuts, and bolts. The Court noted that Progress acquired Debtor's assets only to protect Progress's own investment and to minimize further depletion of Debtor's assets. Nonetheless, the lesson is clear. A lessor should be careful prior to taking over management of a lessee because such actions may open claims that the lessor is liable for all of the debts of the lessee.