

# BANKRUPTCY

A bankruptcy proceeding may intersect with almost any area of governmental practice, whether regulatory, tax, contracts or criminal prosecution. However, for a government attorney not regularly practicing bankruptcy law, the specter of the bankruptcy process can be a source of discomfort. The following are some tips to help the government attorney through the experience.

## Tip 1:

### Understand the Types of Bankruptcy

The chapter under which a bankruptcy is filed appears on the front page of every pleading. Bankruptcies filed under Chapter 7, the most common, concern gathering and liquidating estate assets, mostly the debtor's pre-petition assets and the proceeds or profits thereof. Chapter 7 (and Chapter 11) bankruptcies are either voluntary (filed by the debtor) or involuntary (by creditors). Post-petition earnings are not part of the Chapter 7 estate. A trustee is appointed to administer the estate and distribute the liquidated assets.

Individuals and corporations may be debtors in a Chapter 7. Chapter 7 debtors must turn over to the trustee assets not exempt from collection under state and federal law. Individual Chapter 7 debtors may receive relief in the form of a discharge of pre-petition debt, with exceptions, such as certain taxes and fines. There is no insolvency requirement in voluntary bankruptcies. Voluntary individual bankruptcies may be dismissed where the debtor has excessive net disposable income or consumer debt. The trustee must seek court permission to operate a debtor's business in Chapter 7.

Chapter 13 bankruptcies are voluntary and are limited to individuals with regular income and limited debts. While committing to make regular payments to the standing chapter 13 trustee for the benefit of creditors under a three- or five-year

# FOR THE GOVERNMENT ATTORNEY: A SHORT COURSE

BY DENNIS L. BELCOURT, ESQ.

plan, the debtor is allowed to keep even non-exempt belongings. The amount of the plan payments required depends on the debtor's net disposable income, but must be sufficient to pay off priority claims. If the debtor fulfills plan obligations, they get a "super discharge," including fines and some taxes. If they elect to cut the plan short after the creditors receive what they would have in a Chapter 7 bankruptcy, the discharge is equivalent to that of a Chapter 7. For cause, such as material default on the plan, the bankruptcy court may dismiss the bankruptcy or convert to a Chapter 7.

Least common, the Chapter 11 bankruptcy is managed not by a trustee, but by the debtor as "debtor-in-possession," as a fiduciary of the estate and creditors. He must periodically report on the estate and is subject to supervision by the United States Trustee. For cause, the bankruptcy court may dismiss the Chapter 11 bankruptcy, convert to a Chapter 7, or appoint a trustee or examiner.

A Chapter 11 may be voluntary or involuntary and may involve either reorganization or liquidation of assets, usually pursuant to a plan voted on by creditors after approval of a disclosure statement explaining the plan terms. Debts given bankruptcy priority must be fully paid, except on creditor consent. Liens are preserved or given alternative protections. Chapter 11 corporate reorganizations receive the broadest discharge.

An individual Chapter 11 debtor must commit to paying a portion of his post-petition income to the payment of creditors, after which the debtor may receive a discharge with the same exceptions as a Chapter 7.

## Tip 2:

### Respect the automatic stay

The automatic stay is a common element in all of the chapters. The automatic stay<sup>1</sup> is an injunction against any action against the bankruptcy debtor or the debtor's property, and is intended to give the debtor a breathing spell from collection measures and to preserve the estate for equitable distribution among creditors.<sup>2</sup>

The automatic stay comes into force when a bankruptcy petition is filed. Actions in violation of the stay, even by persons unaware of the bankruptcy, are void. Stay violations made while aware of the bankruptcy, even with a good faith (but erroneous) belief that the actions came within an exception to the stay, may be sanctioned as contemptuous. A stay violation made while ignorant of the bankruptcy petition may be a basis for contempt if not corrected when the violator is made aware. Also, refusal to return estate property received before the bankruptcy may violate the stay.<sup>3</sup>

Actual damages, including attorneys' fees, may be awarded for stay violations, but no punitive damages may be awarded against a governmental unit.<sup>4</sup>

The automatic stay is subject to a number of exceptions, such as criminal proceedings, police power and regulatory proceedings.

A government prosecutor can be reasonably free from doubt that bringing a criminal prosecution against a person who is a debtor in bankruptcy will not violate the automatic stay, by virtue of the exception in 11 USC 362(b)(1).

In contrast, a noncriminal enforcement action under the police and regulatory power exception (11 USC 362(b)(4)) must contend with two tests that require case-specific factual inquiries. They are "the 'pecuniary purpose' test and the 'public policy' test. ... Satisfaction of

either test will suffice to exempt the action from the reach of the automatic stay." Under the pecuniary purpose test, the "court determines whether the government action relates primarily to the protection of the government's pecuniary interest in the debtor's property or to matters of safety and welfare." Under the public policy test, the "court determines whether the government seeks to 'effectuate public policy' or to adjudicate 'private rights.'" Determination of applicability of the exception may be made by a nonbankruptcy court.<sup>5</sup>

On motion of a party, the bankruptcy court may modify, condition or grant relief from the automatic stay. On equitable grounds, the bankruptcy court may annul the stay retroactively.<sup>6</sup> The Nevada Supreme Court has advised that "creditors who are unsure if the stay applies to them should assume the stay is applicable and seek appropriate relief pursuant to 11 USC 362(f)."<sup>7</sup>

## Tip 3:

### Mind the Claim Requirements

Your client has a claim if it has a right to payment, including a right to an equitable remedy the breach of which gives rise to a right to payment. It does not matter whether the right to payment is reduced to judgment, contingent, unmatured, unliquidated, secured or disputed.<sup>8</sup>

A governmental unit should note that filing a proof of claim waives 11th Amendment immunity for counterclaims within the same transaction or occurrence as the claim.<sup>9</sup>

Getting paid on a claim depends on a number of factors, e.g., priority or secured status of the claim, the size of the estate or, in the case of a Chapter 11 or 13, the amount of its expected income. A creditor

continued on page 28

# BANKRUPTCY FOR THE GOVERNMENT ATTORNEY: A SHORT COURSE

continued from page 27



## CHAPTER 13 BANKRUPTCY HEARING

may be able to influence only a few of these factors. Some ways are as follows:

### **Timely file a proper proof of claim**

In a Chapter 11 bankruptcy, if a creditor's claim is scheduled as undisputed and not contingent or unliquidated, the creditor need not file a proof of claim in order to receive a distribution from the bankruptcy. Otherwise, filing a proof of claim is a prerequisite to receiving a distribution.

A proof of claim is timely if filed within 90 days after the date first set for the meeting of creditors. Government units have up to within 180 days after the date of the order for relief (in a voluntary bankruptcy, the petition date). Chapter 7 bankruptcies permit payment of tardy claims. Late filing in a Chapter 11 requires leave of court on excusable neglect. No leave will be granted to file late in a Chapter 13.

Use the standard form for proof of claim, which can be found online. Attach as applicable a copy of a written contract, guaranty or proof of perfection.

### **Watch for Objections and Respond**

The claim will be allowed absent an objection, and a proper proof of claim is prima facie evidence of validity. Failure to file a response to objections may result in disallowance. After a response, the court may schedule an evidentiary hearing. The ultimate burden of proof will likely fall on the claimant. Non-bankruptcy law applies to the substantive validity of claims. Res judicata also applies in bankruptcy.

### **Tip 4:**

### **Be Vigilant in Reviewing the Proposed Plan and Enforcing the Approved Plan**

Chapter 11 and 13 both have plan requirements to protect interested parties, but those interested parties need to be prepared to object to errant plan provisions. Even a plan that should not be confirmed under the law may slip through the process and bind the parties.<sup>10</sup>

The Chapter 13 Trustee monitors compliance with the Chapter 13 plan, but it is up to the interested parties to make sure that the Chapter 11 plan is carried out.

### **Tip 5:**

### **Courtesy Goes a Long Way in Bankruptcy, Too**

Professional courtesy is as important in bankruptcy as in any other practice. Consider calling opposing counsel to resolve matters by stipulation before filing a motion. Resist any inclination to personalize disagreements with other counsel. The bankruptcy bar is small, and word gets around.

Welcome to the practice of bankruptcy law! ■



**DENNIS L. BELCOURT** is Deputy Attorney General for the state of Nevada.

- 1 11 USC §362.
- 2 *In re Christensen*, 167 B.R. 213 (D. Or. 1994).
- 3 *In re Del Mission Ltd.*, 98 F.3d 1147, 1151 (9th Cir 1996).
- 4 11 USC 106(a)3.
- 5 *Lockyer v. Mirant Corp.*, 398 F.3d 1098, 1106 (9th Cir 2005).
- 6 *In re Blaylock*, 301 B.R. 443 (Bkrtcy E.D. Pa. 2003).
- 7 *O'Lane v. Spinney*, 110 Nev. 496, 499-500 (1994).
- 8 11 USC §101(5).
- 9 11 USC §106(b).
- 10 *United Student Aid Funds, Inc. v. Espinosa*, 130 S.Ct. 1367 (2010) (upheld Chapter 13 plan discharge of student debt even though debtor never brought proceeding to determine hardship).