

CONTRACT LAW DIVISION

Office of the Assistant General Counsel for Finance & Litigation

A LAWYER'S VIEW OF BANKRUPTCY

WHAT TO DO WHEN YOUR FAVORITE CONTRACTOR FILES FOR BANKRUPTCY

by Vic Cohen

Relax, there's an "automatic stay" of all actions against the debtor. You can't terminate the contract without first asking the court's permission. If you decide that you want to take some action against the contractor, contact either your local regional attorney or an attorney in the Office of General Counsel, Contract Law Division who will forward the matter to the appropriate U.S. Attorney for action.

The Exciting Details

The Stay

When a government contractor files for bankruptcy under either 11 U.S.C. Chapter 7 (liquidation) or 11 U.S.C. Chapter 11 (reorganization), the automatic stay provisions of the Bankruptcy Code take effect, 11 U.S.C. §362. Several courts have held that one of the acts against a debtor that is prohibited is the termination of a contract. They have reasoned that either termination was a "proceeding" under 11 U.S.C. §362 (a)(1) or "an act to obtain possession of property" (the contractual rights of the debtor constitutes intangible property) pursuant to 11 U.S.C. §362 (a)(3). Violation of the automatic stay can result in various sanctions including being held in contempt of court.

No Automatic Termination

The filing of a bankruptcy petition by a debtor does not and cannot result in the automatic termination of the government contract. If there were a clause in the contract which provided that the filing of the bankruptcy petition was an event of default, it would be void pursuant to 11 U.S.C. §365(e). This section provides that a contract cannot be terminated because of a provision in the contract allowing the termination upon the insolvency of a debtor or the commencement of a case under the Bankruptcy Code. If the contracting officer wishes to terminate the contract, (s)he must have other grounds for default.

How to Terminate

If these grounds exist, then the government must file a motion for relief from the automatic stay pursuant to 11 U.S.C. §362(d). Ordinarily a debtor in possession or a trustee would have the option of assuming or rejecting a contract provided that any defaults were cured. This would result in the government being unable to terminate a contract if the trustee were to cure the defaults. There is, however, an exception in 11 U.S.C. §365 which provides that:

(c) *The trustee may not assume or assign any executory contract or unexpired lease of the debtor, whether*

or not such contract or lease prohibits or restricts assignments of rights or delegations of duties, if:-

(1)(A) applicable law excuses a party, other than the debtor to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and

(B) such party does not consent to such assumption or assignment;

The applicable law is the so called "Anti-Assignment Act" which prohibits the assignment of any government contract as follows:

No contract or order, or any interest therein, shall be transferred by the party to whom such contract or order is given to any other party, and any such transfer shall cause the annulment of the contract or order transferred, so far as the United States are concerned. All rights of action, however, for any breach of such contract by the contracting parties are reserved to the United States...41 U.S.C. §15.



A trustee, therefore, cannot assume a government contract because the "Anti-Assignment Act" prohibits a government contract from being assigned to a third party. This position has been upheld by the United States Bankruptcy Court for the Middle District of Pennsylvania in Pennsylvania Peer Review Organization, Inc., Debtor, 50 B.R. 640 (June 28, 1985).

Conclusion

In conclusion, if a government contractor files a bankruptcy petition and the contracting officer wishes to terminate for a default other than the insolvency of the contractor, a motion for relief from the stay must be filed and the argument should be made that the contract is unassumable pursuant to 11 U.S.C. §365 (c). If you decide to forward the case to one of the attorneys mentioned above, please prepare a report detailing the circumstances of the case and include copies of the relevant documents, i.e., the contract, modifications, correspondence, et cetera.

(See next issue for special 8(a) aspects of bankruptcy matters-Ed)

From the Editor

This first issue of "A Lawyer's View" is an occasional communication of the Contract Law Division designed to discuss topics of interest to Department contracting officers. Comments and suggestions for future topics are actively solicited.- Jerry A. Walz