



CONTRACT LAW DIVISION

Office of the Assistant General Counsel for Finance and Litigation



A Lawyer's View of a Stay in Bankruptcy

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To [Be] Stay[ed] or Not To [Be] Stay[ed], That is the [Contracting Officer's] Question

by
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{T}he filing of a bankruptcy petition operates as a stay, applicable to all entities, of [inter alia] . . . the commencement or continuation, . . . of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the [bankruptcy] case . . . or to recover a claim against the debtor that arose before [prepetition].¹¹ U.S.C. §362 (a)(1)

Introduction

There are many issues that can arise where a contracting officer is faced with the legal labyrinth known as the Federal Bankruptcy Code (11 U.S.C. §§ 101-1330). However, one of the most basic is the circumstance where the contracting officer may want to take some negative action against a contractor, and is notified that the contractor has just filed a petition in bankruptcy. In particular, what is the impact of the bankruptcy code's automatic stay provision on the Government's right to enforce its contracts, and, specifically, its right to terminate a contract for default or convenience? Additionally, how does the stay affect the Government's rights to institute claims for procurement costs after a default, and the bankrupt contractor's right to proceed with and to enforce its termination for convenience claim against the Government?¹

Government's right to Terminate

11 U.S.C. §362(a) stays the commencement of administrative "proceedings" or "actions." The question, therefore, is whether a contracting officer's conduct in terminating a contract (whether for default or convenience) raises to the level of "proceeding" or "action" as those terms are defined. Arguably, neither of these terms describe the conduct of a contracting officer in terminating a contract. Blacks Law Dictionary defines an "action" as a suit brought in court, and a "proceeding" as the form and manner of conducting business before a court or judicial officer. As we all know, a contract termination requires only the delivery of an appropriate notice by the contracting officer to the contractor. To extend the acts of a Contracting Officer to an "action" or "proceeding" would be inappropriate as the terms of the statute are clear as to its intent. Additionally, as Congress in other sections of the statute spoke of stays of "acts,"² it is clear that the Congressional intent was to differentiate and give plain meaning to the terms "actions" and "proceedings."³

"Now What?—The Double Standard

We have terminated the bankrupt contractor's contract for default, and either successfully argued that the stay doesn't apply or have been granted relief from the stay. We have repudiated, with excess procurement expenses. We have a claim—can we do anything about it at the Board? Probably not. Section 362 (a)(1) stays legal proceedings under the CDA against the debtor if they are based on prepetition conduct of the debtor or if they seek to recover a prepetition claim (ie., for money). But how about in the bankruptcy court; as discussed below, maybe. On the other side of the coin, the bankrupt contractor feels the termination for default is improper. He wants to argue that it should be converted into a Termination for Convenience and obtain T/C settlement expenses. Can the bankrupt contractor⁴ do anything about it? Probably.

Clearly conduct by the contracting officer in placing his claim for procurement expenses into a posture where he can actually collect money on behalf of the Government will ultimately involve an "action" or "proceeding" and would be the subject of the stay. However, the stay does not apply to legal or administrative proceedings by the debtor and the debtor need not seek relief from the stay to proceed as a plaintiff with litigation against the Government either in the Board of Contract Appeals or the Court of Federal Claims.⁵ Is that fair? Probably not.

However, this is not to say the Contracting Officer is without any remedy. Although it is clear that the Government can not proceed against the debtor under the Contract Disputes Act without a final contracting officer's decision that establishes the claim, this limitation does not apply to under the Bankruptcy Code. Courts have held that a claim arises for bankruptcy purposes when the Government knew of the debtor's probable liability, despite the federal statute that required a Contracting Officer's decision before the claim arises for CDA purposes.⁶

Can you get "relief?"

Relief is not, to quote the old commercial, "just a swallow away." But it is not impossible. If the Bankruptcy Court involved doesn't accept your argument that the stay doesn't apply because your termination is not an "action" or proceeding" or you want to institute what is unquestionably an "action" or "proceeding" under the Code against the bankrupt, (i.e., outside of the bankruptcy action)⁷ you may seek relief from the stay. Once accomplished, it is

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A Lawyer's View is a periodic publication of the Contract Division designed to provide practical advice to the Department's procurement officers. Comments, criticisms and suggestion for future topics are welcome.—Call Jerry Walz at 202-482-1122, or via e-mail to Jerry Walz@FinLit@OGC or jwalz@sage.ogc.doc.gov.



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Page 2

arguable that you may proceed, not within the Boards of Contract Appeals, but within the Bankruptcy Court to proceed against the debtor for moneys found to be due.

Summary

Although it appears that the Government's rights and the Bankrupt contractor's rights are divergent, the Government may be able to find relief, but not in the venue one would assume those rights exist. In essence, therefore, the Government could pursue the Bankrupt debtor for reprocurement expenses in the Bankruptcy Court while, at the same time, the contractor is pursuing a claim for conversion of a T/D into a T/C with its claim for settlement expenses in the Board of Contract Appeals.

Notes

¹ It is clear that the stay does not apply to prepetition creditor actions, as it has been held that a pre-petition termination of a contract is not subject to the automatic stay (See, e.g. *Moody v Amoco Oil Co.* 734 F.2d. 1200 (7th Circ., 1984).

² See 11 U.S.C. 362 (a)(3-6) dealing with stays of "acts" to obtain possession of property of the [bankruptcy] estate and "acts" to recover on a claim that arose pre-petition.

³ It must be noted that many Bankruptcy Courts as well as commentators on this issue have not agreed with this analysis. If you are faced with this problem, you should file a Motion with the Bankruptcy Court for relief from the stay. This analysis, and much of the information for this article, is taken from an excellent and extensive article on the subject by Samuel Mizel and Tracy J. Whitaker, *The Government's Contractual Rights and Bankruptcy's Automatic Stay: Irreconcilable Differences* found at Vol 25, Public Contract Law Journal, Summer 1996, p. 711 et. seq.

⁴ Normally through the Trustee in Bankruptcy.

⁵ See *Carley Capital Group v. Fireman's Fund Ins. Co.*, 889 F.2d. 1126, 1127 (D.C. Circuit, 1989); *Price & Pierce International Inc., v. Spicers International Paper Sales, Inc.* 50 B.R. 25 (Bankr. S.D.N.Y. 1985)

⁶ See *Kilbarr v. General Serv. Admin. (In re Remington Rand Corp.)*, 836 F.2d. 825 (3rd Circ. 1988)

⁷ Although, as previously mentioned, you have a right to make a claim, your claim may not have any value if there are no assets in the bankrupt estate.