

LJNLAW JOURNAL
NEWSLETTERS

The Bankruptcy *Strategist*[®]

An *incisivemedia* publication

Volume 26, Number 4 • February 2009

Score One for the Good Guys

***Criminal Exception
Overcomes Automatic
Stay for Miscreant Debtor*****By Anthony Michael Sabino**

On countless occasions, the Supreme Court has proclaimed the longstanding axiom that the bankruptcy process is for “honest debtors” only; wrongdoers should never be allowed refuge within the confines of the nation’s insolvency law. *Grogan v. Garner*, 498 U.S. 279, 286 (1991); *Coben v. de la Cruz*, 523 U.S. 213, 217 (1998). Such principles are exemplified numerous times in the modern Bankruptcy Code; for example, the nondischargeability of certain, specific debts, 11 U.S.C. § 523(a), or the denial altogether of the discharge in bankruptcy, 11 U.S.C. § 727(a).

AUTOMATIC STAY AND THE ‘CRIMINAL EXCEPTION’

Often overlooked is the fact that the automatic stay, 11 U.S.C. § 362(a), a linchpin of modern bankruptcy practice, was likewise carefully constructed so as to not provide a safe harbor for malefactors. This is nowhere more pronounced than in the exceptions to the automatic stay for the exercise of the “criminal exception,” 11 U.S.C. § 362(b) (1), and its close cousin, the “police or regulatory power exception.” 11 U.S.C. § 362(b) (4). The former postulates that

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Whose Claim Is It, Anyway?

The Impact of Bankruptcy on Creditor Claims Against Non-Debtors**By Jack L. Smith**

It is often assumed that only creditor claims against a debtor are affected by the debtor’s bankruptcy filing, and that rights against third parties are not. While the logic and simplicity of that assumption are appealing, nothing could be further from the truth in many bankruptcy situations. There is an inherent tension between the claims that may be asserted by creditors against non-debtor parties and those that are in the exclusive realm of the trustee. Not only is this line-drawing an analytical challenge, its outcome may be entirely different depending upon the court involved and the law being applied. Understanding the courts’ treatment of this division of claims (as inconsistent as it is) is essential to a successful litigation strategy, whether on behalf of individual creditors or a trustee.

THE ISSUE

Creditors may have claims against third parties based upon either bargained-for contractual rights or rights arising from the wrongdoing of those parties. Either way, a creditor will naturally look to potential sources of recovery other than the debtor, whose bankruptcy filing necessarily carries with it a diminished capacity to make the creditor whole. Likewise, the trustee (or debtor in possession) may also have claims against other parties that can bring funds into the estate for the benefit of all of the creditors. The division between individual creditor claims and trustee claims is often clear. For example, the trustee has the exclusive right to pursue avoidance claims for preferences, fraudulent transfers, and the like. On the other hand, individual creditors may have independent claims against third parties for whom the estate has no claims, such as direct contractual obligations or tort liability unrelated to the debtor.

There are many instances, however, in which both individual creditors and the trustee may assert claims against the same third parties, arising out of the same or related events. When a creditor and a trustee target the same defendant, it is not

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§ 362 does not stay “the commencement or continuation of a criminal action against the debtor,” while the latter exempts from the automatic stay any exercise of a governmental unit’s police or regulatory power (with certain limitations upon that proviso’s scope). In most instances, the enforcement of these varying stipulations and exceptions is accomplished quietly.

Then again, sometimes a case comes along to remind us that the Bankruptcy Code is not omnipotent, and even powerful strictures such as the automatic stay must fully yield to the exceptions carefully crafted by the legislature to address larger, nonbankruptcy public policy concerns. To be sure, such rare cases remind the bench that it too must yield, and exercise restraint when called upon to enforce § 362, lest it transgress against the plain language of the bankruptcy law.

BARTEL V. WALSH

Such a case is the freshly reported matter of *Bartel v. Walsh* (*In re Bartel*), 395 B.R. 208 (Bankr. D. Mass. 2008), centered upon an adversary proceeding brought by Bartel, the debtor, against defendants including the then-District Attorney of Bristol County, MA. Bartel had made his living as a home construction contractor before filing for Chapter 11. While the reorganization case was pending, and apparently at the behest of certain of Bartel’s customers who alleged they were the victims of a crime, the Massachusetts State Police appeared at the debtor’s home and executed a search warrant, seizing Bartel’s records. *Id.* at 209-10.

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The debtor filed this adversary proceeding, alleging that the D.A., among others, had violated the automatic stay and otherwise worked an unconstitutional deprivation of his civil rights and access to the bankruptcy forum by virtue of pursuing this criminal prosecution. *Id.* at 209-10. While these bankruptcy proceedings were still pending, Bartel was tried and convicted by a state court jury of seven counts of larceny. The state judge sentenced him to prison, and ordered restitution to an amount not then determined. *Id.* at 211-12 and 212 n. 5. In essence, Bartel’s adversary proceeding now demanded relief for all the phases of the law enforcement action taken against him by the state authorities. The defendants then moved for summary judgment, seeking dismissal of the adversary proceeding.

THE COURT’S RESPONSE

Bankruptcy Judge Joel B. Rosenthal posited the conflicting arguments before him as follows: The district attorney contended that § 362 did not stay the criminal action, as the steps taken were lawfully exempted by the words of the statute itself. *Id.* at 211; in counterpoise, the debtor’s principal argument was that the exception to the automatic stay for criminal actions is for such proceedings that do not serve, and are not intended to serve, a debt collection purpose. *Id.* at 212-13.

The Massachusetts bankruptcy court utterly rejected the debtor’s interpretation of § 362 and its exceptions. “This reading is directly contrary to the language” of the statute, “which is categorical, exempting all criminal actions from the automatic stay.” This statutory language is “unambiguous and should be construed according to its plain meaning,” declared Judge Rosenthal. *Id.* at 213.

The *Bartel* court carefully parsed § 362, noting that the automatic stay proviso is actually a well-defined collection of eight statutory prohibitions against commencing or continuing a debt collection action, with similarly detailed exceptions to that broad rule. However, “[t]he criminal

exception applies to all parts of the stay ... [and] is not bound by any part of the stay.” *Id.* at 213 (footnote omitted). Judge Rosenthal held that the statutory language is “categorical and unambiguous. It contains no express exception for those instances in which the criminal prosecution is motivated, in whole or part, by intent to obtain restitution for the alleged victims or to compel payment of a debt.” *Id.* at 213-14. There is no express exemption, observed the *Bartel* court, “for crimes of a financial nature, such as larceny or embezzlement, where the criminal sentence is perhaps more likely to involve a restitution component.” Again, Judge Rosenthal emphasized that this language is “categorical” and unequivocal. *Id.* at 214.

Much to his credit, Judge Rosenthal avoided the temptation to engage in judicial legislation, specifically by refusing to view the criminal exception as some sort of legislative oversight. The bench contrasted the (b) (1) exception for criminal prosecutions, which is wholly unrestricted, with the more limited (b)(4) police or regulatory power exception, the latter of which generally bans an exercise of such governmental power if the true goal is to enforce a money judgment. Judge Rosenthal concluded that the omission of parallel limiting language in the criminal exception was deliberate. The *Bartel* court wisely avoided judicial fiat by writing in an exception that did not exist, and further remarked that “[h]ad [Congress] meant to exclude restitution and money judgments from the scope of the criminal exception, they would have employed similar language.” *Id.* at 214.

Bartel ruled that § 362’s criminal exception must be construed to all criminal proceedings, notwithstanding that they serve a debt collection purpose. The debtor’s proposed construction of the law would nullify the criminal exception, said Judge Rosenthal, and that was a result this court would not countenance. To do so would nullify the criminal exception, because many garden variety

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criminal actions contain some element of restitution, and hence debt collection. Restitution “is a common and legitimate aim of criminal prosecution,” and it is clear that drafters of § 362 crafted the pertinent exception “precisely because criminal prosecutions not infrequently serve a purpose, such as debt collection or debt enforcement.” Judge Rosenthal concluded that “[i]t is precisely those criminal proceedings that the exception appears to have been designed to address.” *Id.* at 214.

THE LIMITED ROLE OF ARTICLE I BANKRUPTCY JUDGES

The *Bartel* court then raised an even more fundamental point; the limited role of Article I bankruptcy judges in the scheme of federalism. Judge Rosenthal opined that if bankruptcy judges were to adopt this debtor’s interpretation of § 362, they would then be compelled to act as courts of review of both federal and state criminal proceedings, even subjecting prosecutors to oversight by the bankruptcy courts. Nowhere in the relevant statute is there even a whisper of such authority being granted to the Article I bankruptcy bench by Congress, and again, Judge Rosenthal showed commendable restraint in not reading anything more into the law than the plain language exception for criminal actions that he found self-evident. *Id.* at 214-15.

SUMMARY JUDGMENT

Last, and as a secondary point, the debtor had contended that the more discriminating scope of the police or regulatory power exception to the automatic stay prohibited law enforcement authorities from seizing estate assets for purposes of restitution. As before, the court rejected *Bartel*’s argument. What this debtor seeks, opined the court, would be “elevating the general above the specific,” insofar as making the more generalized police or regulatory power exception (and

the exemptions within that proviso) control over the more on point criminal exception. Inarguably, the instant case involved a strictly criminal proceeding, and thus the specific exception to § 362 was the only one called into play, so it must govern. And since “[t]he criminal exception is not so limited in scope” as its sibling, the police or regulatory power exception, Judge Rosenthal declared that the former completely

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trumped the strictures of § 362. *Id.* at 215. For all these reasons, the *Bartel* court granted summary judgment to the district attorney, and concluded that, pursuant to the criminal action exception to the automatic stay, the authorities were well within the law in continuing the prosecution that resulted in the incarceration of and penalties against this malefactor.

Bartel is a most welcome case. Upon occasion, advocates and even bankruptcy judges become overzealous in enforcing the strictures of the automatic stay, seeking to ban any and all actions, regardless of the statutory exceptions as so finely detailed within § 362’s plain language. Among the causes championed by this holding, the first is the rule of plain language itself. The court rightly found the Massachusetts prosecution to inarguably fall within the plain English meaning of a criminal proceeding, and then went on to enforce the unquestioned plain language of § 362 and its relevant exception. In no way did this court commit the transgression of straying beyond the plain language of the statute.

Moreover, the *Bartel* court avoided the mistake of judicial legisla-

tion. It recognized that Congress had crafted other, related exceptions within § 362 a certain way, but did no such thing with the criminal exception, although it had ample opportunity to do so. This court soundly rejected any notion of an Article I judge writing something into the statute that the lawmakers had not.

Finally, and on that very note of the Article I status of the nation’s bankruptcy judges, the *Bartel* court recognized the massive danger that would be posed to bedrock principles of federalism, had it adopted this miscreant debtor’s argument that a bankruptcy court could meddle in criminal prosecutions. The court wisely recognized that such matters are left to the states under the principle of federalism, or likewise in the federal arena are reserved to the vastly more powerful Article III bench. Certainly, enforcing the automatic stay in the first instance is a power inarguably granted to the bankruptcy courts. But it must be recalled they are still a tribunal with severely circumscribed jurisdiction. This Massachusetts bankruptcy court confined itself to the appropriate constitutional boundaries, and refused to take any action which would have offended the overarching ideals of jurisprudence.

CONCLUSION

In closing, we commend the *Bartel* case and its wisdom, and predict it will surely become a landmark for thoughtful bankruptcy courts across the land. But at the end of the day, its judgment finally comes down to the cornerstone doctrine that bankruptcy is for honest debtors, not wrongdoers. Put another way, even in bankruptcy courts, the good guys win, the bad guys lose.



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