

Bankruptcy – Maneuvering Through the Process and Avoiding Lawsuits

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I. TYPES OF BANKRUPTCIES

- ▶ Chapter 7 – Liquidation (individuals or businesses)
- ▶ Chapter 9 – Municipalities (cities, counties, townships, school districts, etc.)
- ▶ Chapter 11 – Reorganization (individuals or businesses)
- ▶ Chapter 12 – Family farmers or family fisherman
- ▶ Chapter 13 – Reorganization for individual wage earners

II. AUTOMATIC STAY

▶ **Definition**

An automatic injunction that begins at the moment the bankruptcy petition is filed under Section 362 of the Bankruptcy Code. The stay halts actions by creditors, to collect debts from and take certain actions against a debtor who has declared bankruptcy.

III. VIOLATION OF THE AUTOMATIC STAY

▶ Violation Of The Automatic Stay

Violation of the automatic stay can result in monetary damages, injunctions and/or sanctions.

III. VIOLATION OF THE AUTOMATIC STAY

▶ Debtors' Threats Involving Issuance Of Tax Sale Notices

Debtors have either threatened suit or filed suit against counties for the alleged violation of the automatic stay based upon issuance and/or publication of the tax sale notices. See Exhibit “A” (Merced County Treasurer and Tax Collector’s sample sale notice).

III. VIOLATION OF THE AUTOMATIC STAY

▶ County's Response

As a practical matter, the County has argued that the bankruptcy filing only operates as a stay of a local taxing authority's right to seize, sue, or foreclose or otherwise act to collect a debt – not to assess the tax or impose the related lien upon property of the debtor or of the estate.

IV. EXCEPTIONS TO THE AUTOMATIC STAY

- ▶ 11 U.S.C. § 362(b)(9)(B) provides that the petition does not operate as a stay of "*the issuance to the debtor by a governmental unit of a notice of tax deficiency*".
- ▶ 11 U.S.C. § 362(b)(9)(D) provides that the petition does not operate as a stay of "*the making of an assessment for any tax and issuance of a notice and demand for payment of such an assessment ...*"

IV. EXCEPTIONS TO THE AUTOMATIC STAY

- ▶ 11 U.S.C. § 362(b)(18) provides that the petition does not operate as a stay with regard to *"the creation or perfection of a statutory lien for an ad valorem property tax, or a special tax or special assessment on real property whether or not ad valorem, imposed by a governmental unit, if such tax or assessment comes due after the date of the filing of the petition"*.

V. CASE STUDY

- ▶ *Mendonca v. Merced County Treasurer and Tax Collector*
(Adv. No. 12-14304)
 - ▶ Background Facts
 - ▶ Merced County's Tax Sale Notice
 - ▶ Adversary Proceeding
 - ▶ Costly Discovery Litigation
 - ▶ Depositions

V. CASE STUDY

- ▶ County's Summary Judgment Motion: Arguments
 - The County is statutorily mandated to mail the tax notices under California Revenue and Taxation Code § 3365.
 - The “ministerial act exception” to the automatic stay applies to the County's tax notices (*i.e.*, the County's act of mailing the tax notices constitutes a ministerial act, which is an exception to the automatic stay).

V. CASE STUDY

- ▶ County's Summary Judgment Motion: Arguments (Cont'd)
 - The tax notices are expressly excepted from the automatic stay under 11 U.S.C. §§ 362(b)(9)(B) and 362(b)(9)(D).
 - The County's actions were not "willful", therefore, the debtors are not entitled to any form of damages under 11 U.S.C. § 362(k).
 - The Debtors are not entitled to damages, attorneys' fees or costs.

V. CASE STUDY

- ▶ County's Summary Judgment Motion: Arguments (Cont'd)
 - The Debtors are not entitled to punitive damages because punitive damages are not recoverable against governmental units under 11 U.S.C. § 106(a)(3).
- ▶ Mediation
- ▶ Settlement

Take a break.
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VI. RELIEF FROM THE AUTOMATIC STAY

- ▶ **11 U.S.C. § 362(d)(1) for “Cause”**
 - ▶ (d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay such as by terminating, annulling, modifying, or conditioning such stay –
 - ▶ (1) for cause, including, the lack of adequate protection of an interest in property of such party in interest

VI. RELIEF FROM THE AUTOMATIC STAY

▶ 11 U.S.C. § 362(d)(1) for “Cause”

- ▶ The Bankruptcy Code does not define the term “cause” within the meaning of the statute, which must be determined on a case-by-case basis.
- ▶ Case law holds that the term “cause” is an intentionally broad and flexible concept.
- ▶ Counties have successfully argued that “cause” exists to grant relief from stay based upon the debtors’ tax delinquencies, inability to pay, etc.

VI. RELIEF FROM THE AUTOMATIC STAY

- ▶ **11 U.S.C. § 362(d)(4) for “In Rem Relief”**
 - ▶ (d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay such as by terminating, annulling, modifying, or conditioning such stay -
 - ▶ (4) with respect to a stay of an act against real property . . . by a creditor whose claim is secured by an interest in such real property, if the court finds that the filing of the petition was part of a scheme to **delay, hinder or defraud creditors** that involved either –

VI. RELIEF FROM THE AUTOMATIC STAY

- ▶ **11 U.S.C. § 362(d)(4) for “In Rem Relief” (Cont’d)**
 - ▶ (A) **transfer** of all or part of ownership of, or other interest in, such **real property without the consent of the secured creditor** or court approval; or
 - ▶ (B) **multiple bankruptcy filings** affecting such real property.
- ▶ **Tip:** A properly obtained in rem relief order recorded in compliance under applicable state law will be binding in any other bankruptcy case affecting such real property for two (2) years.

VII. CRITICAL DEADLINES IN BANKRUPTCY

- ▶ **Upon receiving notice of a Debtor's bankruptcy, below are some critical deadlines to monitor/calendar:**
- ▶ **341(a) Meeting of Creditors** – Chapter 7 Trustee or U.S. Trustee conducts meeting for creditors to appear and question Debtor.
- ▶ **Proof of Claim Deadline** - Local governments have 180 days from the order for relief (*i.e.*, petition date) to file a proof of claim under Section 502(b)(9) unless later date specified in bankruptcy notice.

VII. CRITICAL DEADLINES IN BANKRUPTCY

- ▶ **Upon receiving notice of a Debtor's bankruptcy, below are some critical deadlines to monitor/calendar (Cont'd):**
- ▶ **Deadline to Object to Disclosure Statement / Plan** – it is critical that the deadlines for objecting to the Disclosure Statement and/or Plan be monitored and calendared.
- ▶ **Deadline to Answer/Respond to Complaint** – this deadline is typically stated in the Summons served with the Complaint.

VIII. HOW TO FILE PROOF OF CLAIM

- ▶ **TIP:** Make certain both the Proof of Claim and attachment contain sufficient information to avoid any potential claim objections by Debtor or the Trustee. The attachment should consist of, among other things, the County's tax invoices issued to debtor and any other documents evidencing the debt. See Exhibit "B" (Sample Proof of Claim).

- ▶ **Tip:** Make certain to only include the amounts owed as of the petition date. Proof of Claim form indicates that creditors should not use form to make a request for payment of an administrative expense.

VIII. HOW TO FILE PROOF OF CLAIM

- ▶ **Tip:** Make certain that Proof of Claim is timely filed in order to avoid any objections to claims.
- ▶ **Tip:** Governmental units are not required to file proofs of claim for administrative expense claims or requests for payment in order to have these amounts deemed “allowed” pursuant to 11 U.S.C. § 503(b)(1)(D).

IX. TYPES OF TAX CLAIMS

- ▶ Secured tax claims
- ▶ Unsecured tax claims
- ▶ Unsecured priority tax claims – certain unsecured claims of governmental units. See 11 U.S.C. § 507(a)(8).
- ▶ Administrative expense claims – generally, any secured or unsecured tax incurred by the estate (*i.e.*, which typically arises during post-petition period).

X. DISCLOSURE STATEMENT AND PLAN

- ▶ The Disclosure Statement must contain adequate information describing, among other things, the County's taxes, penalties and interest under applicable state law and federal law (*i.e.*, make certain that the County receives 10% and 18% interest). See 11 U.S.C. § 511.
- ▶ The Plan of Reorganization must similarly contain accurate information regarding the taxes, penalties and interest. See 11 U.S.C. § 511.

X. DISCLOSURE STATEMENT AND PLAN

▶ Potential Objections:

- ▶ In chapter 13, plan payments cannot exceed five (5) years. See 11 U.S.C. § 1322(d)(1) .
- ▶ In chapter 11, plan payments cannot exceed five (5) years from the petition date. See 11 U.S.C. §§ 1129(a)(9)(C)(ii) and 1129(a)(9)(D).
- ▶ Governmental units are not required to file a request for payment of an administrative expense claim. See 11 U.S.C. § 503(b)(1)(D).

XI. SUBORDINATION OF PENALTIES IN CHAPTER 7 CASES

- ▶ Chapter 7 Trustees possess the statutory authority to subordinate certain "penalties" and avoid the liens for such penalties. See 11 U.S.C. § 724(a).
- ▶ Section 724(a)
 - ▶ Section 724(a) provides that "[t]he trustee may avoid a lien that secures a claim of a kind specified in section 726(a)(4) of this title".

XI. SUBORDINATION OF PENALTIES **IN CHAPTER 7 CASES**

▶ Section 726(a)(4)

- ▶ In turn, Section 726(a)(4) provides in material part, that, property of the estate shall be distributed . . . fourth, in payment of any allowed claim, whether secured or unsecured, for any fine, penalty, or forfeiture, . . . arising before the earlier of the order for relief or the appointment of a trustee, ***to the extent that such fine, penalty, forfeiture, or damages are not compensation for actual pecuniary loss suffered by the holder of such claim"*** (emphasis added).

XI. SUBORDINATION OF PENALTIES **IN CHAPTER 7 CASES**

▶ General Translation:

- ▶ The trustee may subordinate certain penalties and avoid the lien if the Court determines that such pre-petition "fine" or "penalty" does not constitute "compensation for actual pecuniary loss".

XI. SUBORDINATION OF PENALTIES IN CHAPTER 7 CASES

▶ In Practice:

- ▶ Certain chapter 7 trustees have initiated adversary proceedings against taxing authorities arguing that the penalties are punitive in nature (i.e., intended to punish as opposed to compensate for actual pecuniary loss), and should therefore be subordinated and the liens avoided under Section 724(a).

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QUESTIONS?



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EXHIBIT "A"

NOTICE OF TAX COLLECTOR'S IMPENDING POWER TO SELL

NAME
ADDRESS
ADDRESS

Pursuant to California Revenue and Taxation Code Section 3691(a)(3), requisite notice is hereby given that on the first day of July 2017, at the hour of 12:01 a.m., the real property described herein will become subject to the power to sell of the undersigned Merced County Tax Collector. If the real property subject to this notice is the subject of a bankruptcy proceeding, this notice shall constitute "a notice of tax deficiency" pursuant to 11 U.S.C. § 362(b)(9)(B).

Unless the property is redeemed or an installment redemption plan initiated (if eligible) prior to the close of business (5 p.m.) of the last business day of June, 2017, upon which date five or more years will have elapsed from the date the property became tax-defaulted, it will become subject to sale. If the property is not redeemed, the right of redemption will terminate at 5 p.m. on the last business day prior to the date the sale begins.

Information concerning redemption or the initiation of an installment redemption plan will, upon request, be furnished by:

Karen D. Adams, C.P.A., Merced County Tax Collector
2222 M Street, Merced CA 95340-3780
209-385-7592

NOTE: If the property is not redeemed and is sold at a tax sale, you may have the right to claim proceeds of the sale that are in excess of the liens and costs to be satisfied from the proceeds. Parcels not sold at the scheduled tax sale may be re-offered for sale within a 90-day period.

If you are currently in bankruptcy and have commenced making payments to the appointed bankruptcy Trustee pursuant to Court order, please continue to make such payments to the appointed Trustee. Pursuant to 11 U.S.C. § 362(b)(9)(B), all notices will continue to be sent to the property owner and all processes will continue up to the last day of redemption. Please be advised that any property or properties in active bankruptcy shall be pulled from the sale prior to the sale commencement date and will not be sold.

Said property was tax-defaulted in the year 6/30/2012.

The property becoming subject to the tax collector's power of sale and subject to this notice is situated in Merced County, State of California, and described as follows:

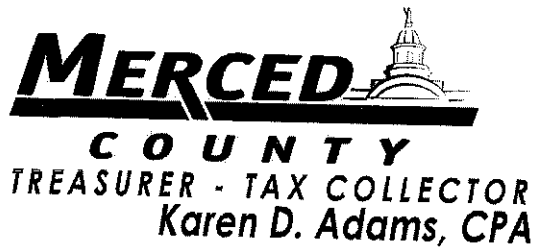
Assessor's Parcel No. 000-000-000-000

The amount due must be paid in **Cash, Cashier's Check or Money Order** and must be **received** in this office no later than 5 p.m. on June 30, 2017. (U.S. Postmark is NOT acceptable).

Amount Due to Redeem by June 30, 2017 is \$560.30.

Dated this 1ST day of June, 2017

KAREN D. ADAMS, CPA
Merced County Tax Collector, State of California



Karen D. Adams, CPA
Treasurer-Tax Collector

2222 "M" Street
Merced, CA 95340
(209) 385-7307
(209) 725-3905 (Fax)
<http://www.mercedtaxcollector.org>

September 12, 2017

Trustee Name
Trustee Address
Trustee Address

RE: **Client Name** – Bankruptcy # **16-00000**- APN # **000-000-000-000**

Dear Sir,

Please be advised that Parcel Number(s) or (APN) **000-000-000-000** owned by the above-referenced tax payer has defaulted taxes dating back to tax year **2011**. Thus, the property will be eligible for tax sale and a Power To Sell will be filed on **7/12/2016** as required under California Revenue and Taxation Code §3364.

Pursuant to 11 U.S.C. §362(b)(9)(B), all notices will continue to be sent to the property owner and all processes will continue up to the last day of redemption in **Tax Sale Date**.

Please be advised that bankruptcy accounts are flagged in our system and closely monitored. Thus, any property or properties in active bankruptcy shall be pulled from the sale prior to the sale commencement date and will not be sold.

Please feel free to contact me with any questions.

Sincerely,

TCC Name
Tax Collector Clerk II
Merced County Tax Collector

Cc: **Taxpayer**

EXHIBIT "B"

Fill in this information to identify the case:

Debtor 1 _____
Debtor 2 _____
(Spouse, if filing)
United States Bankruptcy Court for the: Central District of California
Case number _____

Official Form 410 Proof of Claim

4/16

Read the instructions before filling out this form. This form is for making a claim for payment in a bankruptcy case. Do not use this form to make a request for payment of an administrative expense. Make such a request according to 11 U.S.C. § 503.

Filers must leave out or redact information that is entitled to privacy on this form or on any attached documents. Attach redacted copies of any documents that support the claim, such as promissory notes, purchase orders, invoices, itemized statements of running accounts, contracts, judgments, mortgages, and security agreements. Do not send original documents; they may be destroyed after scanning. If the documents are not available, explain in an attachment.

A person who files a fraudulent claim could be fined up to \$500,000, imprisoned for up to 5 years, or both. 18 U.S.C. §§ 152, 157, and 3571.

Fill in all the information about the claim as of the date the case was filed. That date is on the notice of bankruptcy (Form 309) that you received.

Part 1: Identify the Claim

1. Who is the current creditor?		
Name of the current creditor (the person or entity to be paid for this claim) _____		
Other names the creditor used with the debtor _____		
2. Has this claim been acquired from someone else?		
<input type="checkbox"/> No		
<input type="checkbox"/> Yes. From whom? _____		
3. Where should notices and payments to the creditor be sent?		
Federal Rule of Bankruptcy Procedure (FRBP) 2002(g)	Where should notices to the creditor be sent?	Where should payments to the creditor be sent? (if different)
	Name _____	Name _____
	Number _____ Street _____	Number _____ Street _____
	City _____ State _____ ZIP Code _____	City _____ State _____ ZIP Code _____
	Contact phone _____	Contact phone _____
	Contact email _____	Contact email _____
Uniform claim identifier for electronic payments in chapter 13 (if you use one): _____		
4. Does this claim amend one already filed?		
<input type="checkbox"/> No		
<input type="checkbox"/> Yes. Claim number on court claims registry (if known) _____		
		Filed on _____ MM / DD / YYYY
5. Do you know if anyone else has filed a proof of claim for this claim?		
<input type="checkbox"/> No		
<input type="checkbox"/> Yes. Who made the earlier filing? _____		

Part 2: Give Information About the Claim as of the Date the Case Was Filed

6. Do you have any number you use to identify the debtor? No
 Yes. Last 4 digits of the debtor's account or any number you use to identify the debtor: _____

7. How much is the claim? \$_____ Does this amount include interest or other charges?
 No
 Yes. Attach statement itemizing interest, fees, expenses, or other charges required by Bankruptcy Rule 3001(c)(2)(A).

8. What is the basis of the claim? Examples: Goods sold, money loaned, lease, services performed, personal injury or wrongful death, or credit card.
Attach redacted copies of any documents supporting the claim required by Bankruptcy Rule 3001(c).
Limit disclosing information that is entitled to privacy, such as health care information.

9. Is all or part of the claim secured? No
 Yes. The claim is secured by a lien on property.

Nature of property:

Real estate. If the claim is secured by the debtor's principal residence, file a *Mortgage Proof of Claim Attachment* (Official Form 410-A) with this *Proof of Claim*.

Motor vehicle

Other. Describe: _____

Basis for perfection: _____

Attach redacted copies of documents, if any, that show evidence of perfection of a security interest (for example, a mortgage, lien, certificate of title, financing statement, or other document that shows the lien has been filed or recorded.)

Value of property: \$ _____

Amount of the claim that is secured: \$ _____

Amount of the claim that is unsecured: \$ _____ (The sum of the secured and unsecured amounts should match the amount in line 7.)

Amount necessary to cure any default as of the date of the petition: \$ _____

Annual Interest Rate (when case was filed) _____ %

Fixed

Variable

10. Is this claim based on a lease? No
 Yes. Amount necessary to cure any default as of the date of the petition. \$ _____

11. Is this claim subject to a right of setoff? No
 Yes. Identify the property: _____

12. Is all or part of the claim entitled to priority under 11 U.S.C. § 507(a)?

- No
 Yes. Check all that apply:

A claim may be partly priority and partly nonpriority. For example, in some categories, the law limits the amount entitled to priority.

- Domestic support obligations (including alimony and child support) under 11 U.S.C. § 507(a)(1)(A) or (a)(1)(B).
- Up to \$2,850* of deposits toward purchase, lease, or rental of property or services for personal, family, or household use. 11 U.S.C. § 507(a)(7).
- Wages, salaries, or commissions (up to \$12,850*) earned within 180 days before the bankruptcy petition is filed or the debtor's business ends, whichever is earlier. 11 U.S.C. § 507(a)(4).
- Taxes or penalties owed to governmental units. 11 U.S.C. § 507(a)(8).
- Contributions to an employee benefit plan. 11 U.S.C. § 507(a)(5).
- Other. Specify subsection of 11 U.S.C. § 507(a)() that applies.

Amount entitled to priority

\$ _____

\$ _____

\$ _____

\$ _____

\$ _____

\$ _____

* Amounts are subject to adjustment on 4/01/19 and every 3 years after that for cases begun on or after the date of adjustment.

Part 3: Sign Below

The person completing this proof of claim must sign and date it. FRBP 9011(b).

If you file this claim electronically, FRBP 5005(a)(2) authorizes courts to establish local rules specifying what a signature is.

A person who files a fraudulent claim could be fined up to \$500,000, imprisoned for up to 5 years, or both. 18 U.S.C. §§ 152, 157, and 3571.

Check the appropriate box:

- I am the creditor.
- I am the creditor's attorney or authorized agent.
- I am the trustee, or the debtor, or their authorized agent. Bankruptcy Rule 3004.
- I am a guarantor, surety, endorser, or other codebtor. Bankruptcy Rule 3005.

I understand that an authorized signature on this *Proof of Claim* serves as an acknowledgment that when calculating the amount of the claim, the creditor gave the debtor credit for any payments received toward the debt.

I have examined the information in this *Proof of Claim* and have a reasonable belief that the information is true and correct.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on date _____
 MM / DD / YYYY

Signature _____

Print the name of the person who is completing and signing this claim:

Name _____
 First name Middle name Last name

Title _____

Company _____
 Identify the corporate servicer as the company if the authorized agent is a servicer.

Address _____
 Number Street

City State ZIP Code

Contact phone _____ Email _____