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Municipal Newsletter

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Bankruptcy and Municipal Services

In today's uncertain economy, an undesirable possibility municipal governments and authorities may inevitably be forced to confront is the issue of bankruptcy declaration by customers.

Based upon their individual circumstances, a party may file for bankruptcy for various reasons under the Bankruptcy Code. The following are filings typical of not only customers of municipalities but anyone. A Chapter 7 filing pertains to liquidation of assets and dissolution of the entity. This form of filing can be utilized by either a business or an individual. Chapter 11 filings concern reorganization of the entity and primarily involve businesses, though individuals can also file under this Chapter. Chapter 13 filings are particular for debt adjustment of an individual. The debtor is the individual or company who files for bankruptcy. The creditor is the entity who is owed something (usually money) from the debtor at the time of the filing.

Whenever a debtor files for bankruptcy, regardless of the Chapter under which the debtor is filing, an automatic stay is initiated. The automatic stay halts all actions of creditors to collect whatever monies or other property is owed them. The purpose of the automatic stay is to provide protection to the debtor and his/her assets from any interference of the creditor. Any collection action ignoring the automatic stay will incur strict penalties against the creditor, regardless of who is the creditor.

Notwithstanding, the automatic stay only protects against claims of creditors prior to the bankruptcy filing. Collections for claims after the filing are permitted, even if the bankruptcy case is still happening. For municipal service customers, among others, it is necessary to determine when the obligation was incurred. If the service was provided before the filing, but a bill was sent after the bankruptcy, then the municipality is subjected to the automatic stay, because the service commenced the obligation for payment, not the bill. It should be noted, even though a creditor has a claim against a debtor that is after the bankruptcy filing, execution against the debtor's property is not permissible without the bankruptcy court allowing it.

According to Section 366(a) of the Bankruptcy Code:

> Except as provided in subsections (b) and (c)… a utility may not alter, refuse or discontinue service to or discriminate against the trustee or the debtor solely on the basis of the commencement of a case under this title or a debt owed by the debtor to such utility for service rendered before the order for relief was not paid when due.

That is to say, the utility provider, such as the municipality, must treat the debtor as any customer who has not filed for bankruptcy. The filing cannot be a stigma against the debtor for which services are denied. Furthermore, the provider cannot stop service because of the bankruptcy filing, and the provider must continue service even if such service was halted before the bankruptcy filing. Basically, debtors are to be treated as non-debtors by the utility provider.

Relative to filings under Chapters 7 and 13 of the Bankruptcy Code, Section 366(b) states:

> Such utility may alter, refuse or discontinue service if neither the trustee nor the debtor, within 20 days after the date of the order for relief, furnishes adequate assurance of payment, in the forms of a deposit or other security, for service after such date. On request of a party in interest and after the notice and a hearing, the court may order reasonable modification of the amount of the deposit or other security necessary to provide adequate assurance of payment.

Before 20 days have lapsed after the bankruptcy case is in effect, either the bankruptcy trustee or the debtor must deliver to the utility provider an assurance payment will be made for the services rendered. Otherwise, the provider may discontinue such service. If the parties cannot agree on what qualifies as "adequate assurance", the Bankruptcy Court will make a determination. Although the Bankruptcy Code does not specify what the "adequate assurance" should be, the Bankruptcy Court tends to rely on the regulations of state public utilities to decide what is acceptable.

For filings under Chapter 11 of the Bankruptcy Code, Section 366(c)(2) directs:

> Subject to paragraphs (3) and (4)… a utility referred to in subsection (a) may alter, refuse or discontinue utility service, if during the 30-day period beginning on the date of the filing of the petition, the utility does not receive from the debtor or the trustee adequate assurance of payment for utility service that is satisfactory to the utility.

Subsection 366(c)(1) identifies the "assurance of payment" to be a cash deposit, a letter of credit, a certificate of deposit, a surety bond, a prepayment of utility consumption or another form of security that is mutually agreed upon between the utility and the debtor or trustee. However, an administrative expense priority shall not constitute an assurance of payment.

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Although the debtor (or trustee) is afforded 30 days, as opposed to the 20 days of the filers of Chapter 7 and 13 bankruptcies, it is the provider who determines what will be agreeable for the adequate assurance of payment. Thus, unless the Bankruptcy Court rules otherwise, the debtor (or trustee) will be required to make the necessary assurance, or the provider may discontinue service. In making its determination relative to the adequateness of the assurance of payment per the request of an interested party, the Bankruptcy Court, according to Subsection (c)(3)(B) may not consider "the absence of security before the date of the filing of the petition, the payment by the debtor of charges for utility service in a timely manner before the date of the filing of the petition or the availability of an administrative expense priority."

Additionally pertinent to providers dealing with filers under Chapter 11, per Subsection (c)(4), "a utility may recover or set off against a security deposit provided to the utility by the debtor before the date of the filing of the petition without notice or order of the court." That is, without notice or court order, the provider may use the security towards the debtor's debt that accrued either before or after the bankruptcy filing.

Regardless of the chapter of the Bankruptcy Code under which the debtor files, the provider may terminate services to the debtor for any payments the debtor fails to make for obligations after the bankruptcy filing. The only requisite to which providers must stringently adhere is the laws of the state concerning shut-off procedures.

An option municipalities and providers may consider to improve their chances of eventually being paid by the debtor is the filing of a Proof of Claim. Though this can be beneficial for the creditor, this option subjects the creditor and his/her/its claim to the jurisdiction of the Bankruptcy Court.

Nevertheless, regardless of the situation, an attorney who is well-experienced in bankruptcy matters should be consulted when dealing with such potentially complex issues. At Leventry, Haschak & Rodkey, LLC we have two attorneys available for such matters.

Miscellaneous

In our previous issue relative to the municipal clients of our attorneys, we neglected to mention Bolivar Borough as a client of Attorney Jeffrey W. Miller. We apologize for the oversight.