



## Beware of Bankruptcy Filings: Tips to Help Protect A Municipality's Interests in a Bankruptcy Case

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Bankruptcies involving individuals and companies are up in 2010. Though some economic indicators show improvement, data suggests more private bankruptcy filings will occur in 2010 than in 2009. Chances are good, then, that a Municipality may receive some notice of a bankruptcy. Ignore that mail at your own peril. Pay very, very close attention to any mail involving a bankruptcy case – because every bankruptcy case in which the Debtor owes the Municipality has the potential to affect a Municipality's interests. Consider the following hypotheticals:

*Imagine that a resident of your Municipality files bankruptcy. In that bankruptcy, the Debtor proposes to pay none of the outstanding property taxes owed to the Municipality. How can the Municipality protect its right to receive full payment for the outstanding taxes?*

*Imagine that your Municipality bought a truck chassis, and hired Buffalo Company to convert that chassis into a Police Truck. After the Municipality paid Buffalo Company \$100,000 for the work but before the work was done, Buffalo Company files bankruptcy because it owes a third party millions of dollars due to a court judgment. The third party wants to seize the chassis and sell it to recoup some of the money Buffalo Company owes it. How can the Municipality protect its interest in the truck chassis?*

Below is a short, basic primer on bankruptcies – including reasons to give special care to any correspondence a Municipality receives about a bankruptcy case and how a Municipality can protect its interests that otherwise might be harmed during a bankruptcy.

### **WHAT IS VOLUNTARY BANKRUPTCY?**

Bankruptcy is filed by an individual or company to obtain financial relief. The person or company filing bankruptcy is referred to as a

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"Debtor."

**ARE THERE DIFFERENT TYPES OF BANKRUPTCIES?**

Yes. There are basically two types of bankruptcy cases. The first type, a Chapter 7 case, totally eliminates the Debtor's debt. The second type, a Chapter 13 for individuals and Chapter 11 for companies, reorganizes the Debtor's debt and provides for partial debt relief.

**HOW COULD A BANKRUPTCY CASE ELIMINATE A DEBT OWED TO A MUNICIPALITY?**

Any debt that the Debtor owes to the Municipality can be potentially affected in a bankruptcy case. This could include, for example, water bills, sewer bills, or certain personal or real property taxes.

**CAN A BANKRUPTCY CASE IMPACT A MUNICIPALITY'S OWNERSHIP OR INTEREST IN ANYTHING ELSE BESIDES A DEBT?**

Yes. A bankruptcy case could also put at risk a Municipality's interest in bigger ticket items – such as noted in one of the hypotheticals above: a vehicle that the Municipality owns but which is in the possession of the Debtor. In short, every interest – financial or tangible – that the Municipality has and which is somehow related to the Debtor is potentially at risk in a bankruptcy.

**HOW WOULD A MUNICIPALITY FIND OUT THAT THERE IS A BANKRUPTCY THAT POTENTIALLY AFFECTS ITS INTERESTS?**

The simplest answer is by either mail or word-of-mouth. As to mail, a Municipality could receive documents from the bankruptcy court identifying the bankruptcy and noting how the Debtor seeks to dispose of a debt owed to the Municipality or an item in which the Municipality claims an interest. Bankruptcy courts issue various types of documents, but the most common documents that a Municipality might receive of a Debtor's bankruptcy filing are the following:

- **Notice of Bankruptcy Filing**. If the Debtor lists the Municipality as a creditor that the Debtor owes money, the Court will send a notice of bankruptcy to the Municipality;
- **Notices of Dividends, Motions for Relief From Stay, Debtor's Plan**. After the notice of bankruptcy, depending on the chapter, the Municipality could receive a notice of dividends, motions for relief from stay, or the Debtor's plan. The Debtor's plan proposes how the Debtor's debt will be handled amongst all creditors – i.e., how the payments will take place, at what interest rate, and over what period of time;

Each bankruptcy mailing should be given careful attention and likely forwarded to a bankruptcy attorney to evaluate.

**WHAT IF THE DEBTOR DOES NOT LIST THE MUNICIPALITY AS A CREDITOR? HOW DOES THE MUNICIPALITY GET NOTICE THEN?**

If the Debtor does not list the Municipality as a creditor, the Municipality will not receive notice – even if it is owed money. For that reason, a Municipality really must stay aware of persons or companies with whom it is



doing business. If it hears news of that person or company perhaps filing bankruptcy, the Municipality can either investigate further on its own, or ask an attorney to investigate the bankruptcy court dockets.

**WHAT SHOULD A MUNICIPALITY DO IF IT RECEIVES NOTICE OF A PRIVATE BANKRUPTCY?**

If a Municipality receives notice of a bankruptcy, the first thing it should do is consider contacting an attorney. This is because bankruptcy cases have many deadlines and are extremely time-sensitive. Although each bankruptcy case is different, sometimes there is little attorney time needed to protect the Municipality's interests. For example, if the debtor lists the Municipality in the plan and the payment terms are acceptable, then little attorney time would be needed.

The second thing the Municipality must do is stop collections efforts against the Debtor. From the moment a bankruptcy case is filed, bankruptcy laws require that all who the Debtor owes money to stop collection efforts on the debt owed before the date of filing bankruptcy. The Municipality should contact an attorney to determine how to proceed in the bankruptcy case to collect the debt owed.

**WHAT COULD HAPPEN IF A MUNICIPALITY RECEIVES NOTICE OF A BANKRUPTCY BUT DOES NOTHING ABOUT IT?**

Many potential detrimental things can happen if a Municipality does not take quick actions in a bankruptcy case. If the Municipality is owed money and the Debtor proposes to pay less than what the Debtor owes, then the Municipality could lose its right to object if the Municipality does not respond, or waits too long to respond to a bankruptcy notice. Likewise, failure to timely respond could lead to the Municipality losing any interest it may have in property (e.g., vehicle or property) it owns but which the Debtor has possession.