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Government Contracts and Bankruptcy: What Happens When Things Go South?

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BANKRUPTCY PERSPECTIVE

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SPECIAL ISSUES RELATING TO EMPLOYEE CLAIMS IN GOVERNMENT CONTRACTOR BANKRUPTCIES

In a government contractor bankruptcy, employee claims pose a challenge for the Trustee or Debtor in Possession.

Special Rights of the United States Government

The Department of Labor will make demand on all agencies to hold any funds due to the Debtor under any contract if there are wage claims under the Service Contract Act until those claims are finally determined. The Internal Revenue Service may also make such a demand.

The United States is considered a unitary entity for purposes of set off, so even if there is a substantial secured creditor that has perfected its claims with a UCC-1 procedure, that creditor will not be able to override these demands unless it has an assignment pursuant to the Assignment of Claims Act. The statute is set out at 31 U.S.C. § 3727 and 41 U.S.C. § 15. It is implemented through Subpart 32.8 of the FAR. The assignment requires consent of the Government. Once signed, from the viewpoint of the lender, by far the most significant aspect of the statute is set out in FAR 32.804 "Extent of Assignee's Protection." To the extent that it lends funds after the assignment is executed, the lender is protected from set off on any claim arising independent of the contract, and for claims arising under the contract for taxes, penalties, renegotiations, fines and tax withholdings.

A lender can obtain additional protections through this statute if it is a "financial institution," if the assignment is for the entire contract unless specifically otherwise authorized, all notice requirements are met and the appropriate government representative signs off on the contract.

The main differentiation occurs if the United States Government has a claim against the Debtor unrelated to the pledged receivable. As an example, a contractor could be subject to a general corporate tax claim from prior years. If the lender has only a UCC, the United States will set off that claim against the contract receivable to the detriment of both the debtor and the secured creditor. If the creditor, however, has a valid assignment of claim pursuant to the statute, it is protected from this kind of unrelated set off. This provides protection for the creditor, but also for the debtor. If the secured creditor is not paid, then the debtor may well lack the revolving cash flow necessary to continue performance of the contract. This differentiation continues both in a bankruptcy and outside of a bankruptcy.

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Determination and Payment of Employee Claims

Timing and payment of the employee claims pose a particular challenge. The Department of Labor has its own particular audit procedure that can take years to complete if there are large numbers of employees. This creates a problem because no funds will be released until the final amounts are determined, thereby creating a substantial logjam in the bankruptcy process. As a practical matter as well, employees will be uninterested in the reasons for the delay and will continually contact the Debtor in Possession or the Trustee to try to obtain payment. The Department of Labor does not interface with the Court Electronic Case Filing System ("ECF") and, therefore, will not have current addresses to contact employees. Filing of a change of address or a proof of claim in the bankruptcy will not suffice to solidify the employee's claim with the Department of Labor, as different procedures are required.

The Department of Labor will not distribute funds to the Trustee or the Debtor in Possession for distribution. It makes the distributions directly and then provides the information to the Debtor. It pays only the employee portion of withholdings. The employer portion of withholdings is not paid by the Department of Labor and the estate is responsible for those. This creates substantial issues because reporting to the estate is not always timely, and the estate may not have the funds to make those payments. As these are seen by the Internal Revenue Service as post-petition, any fees or penalties for failure to pay or failure to pay timely must be challenged by the Trustee or debtor in Possession

Not all employees are covered under the Service Contract Act. Employees such as field supervisors and central office personnel are not covered and they will have to rely on payments from the bankruptcy estate. This is a source of great confusion particularly to employees who may see themselves as field employees.

The amounts of claims are also problematical. Not all amounts that could fall within a priority Bankruptcy Code claim are necessarily allowed under the Service Contract Act. Employees may therefore file proofs of claim in different amounts from the amounts allowed by the Department of Labor and the process of determining these claims can be difficult.

This particular area demonstrates the difficulty of trying to reconcile these two different statutory and regulatory schemes, even in a situation such as this one in which each is an expression of the intention of Congress to protect employees.

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BANKRUPTCY ISSUES FOR THE GOVERNMENT CONTRACTS PROFESSIONAL: THE AUTOMATIC STAY AND RELIEF FROM THE STAY

Automatic Stay and Property of the Estate

Overview

The "automatic stay" and "property of the estate" are two of the most basic and essential concepts to understanding bankruptcy.

At least two things occur automatically when a debtor files a bankruptcy petition. First, all the debtor's property (whether it be real property, personal property, intellectual property, claims, or rights under contracts) become property of the debtor's bankruptcy estate.[1] All this "property of the estate" comes under the oversight and protection of the Bankruptcy Court overseeing the debtor's case.

Second, the automatic stay goes into effect. The automatic stay enjoins most creditors and parties in interest from taking actions adverse to the debtor or property of the estate.[2] In short, the stay prevents creditors from pursuing claims that arose before the bankruptcy petition was filed ("pre-petition"). The stay goes into effect even if a creditor or other party is not aware of the bankruptcy filing. It goes into effect immediately, no court order is needed. For example, it is not uncommon for a homeowner to file for bankruptcy right before his house is to be foreclosed upon. The automatic stay will stop (though perhaps not permanently) the foreclosure.

There are several rationales for the automatic stay. One main goal of the stay is to give the debtor breathing room, a break from what might be a situation where the debtor is trying to contend with multiple creditors. With creditors temporarily being held at bay, the Bankruptcy Court overseeing the debtor's assets can ensure an orderly and fair resolution of the debtor's case. The automatic stay also allows the debtor or the trustee put in charge of the debtor time to assess the debtor's assets and liabilities, and determine how to reorganize, liquidate, or otherwise manage the debtor's estate. In short, the stay helps prevent a debtor from being picked apart by creditors' "rush to the courthouse."

A creditor or other party in interest that violates the stay may be subject to sanctions, penalties and damages claims. Depending on the situation, a violation may not result in sanctions, penalties or damages if the violation was unintentional (i.e. the party was not aware of the stay.) A party that is aware of the stay and takes actions in violation thereof may find itself facing a damages claim totaling the amount of legal fees the debtor incurred in opposing the stay violation, as well as additional penalties.

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[1] 11 U.S.C. § 541.
[2] 11 U.S.C. § 362.

Key points about the automatic stay and property of the estate:

- All of the debtor's pre-petition property becomes property of the estate including, but not limited to, intangible property such as contracts an intellectual property
- The automatic stay is an injunction that stops actions against and efforts to obtain property of the debtor
- Upon filing for bankruptcy, the debtor is *automatically* protected by the automatic stay – no court order is needed
- It is irrelevant if a creditor or other party in interest is not aware of the bankruptcy filing – the stay is still in effect
- A creditor or other party that violates the automatic stay can be assessed a penalty; generally, a stay violation will result in penalties only if it is an intentional violations (i.e. the party knew the stay was in effect and it pursued the offending action)
- Provides the debtor with a "breathing spell"

Automatic stay: What does it cover?

Many actions are subject to the automatic stay, including those that may not, at first glance, appear to be relevant. Examples include:

- For a claim that arose pre-petition, both initiating a suit against the debtor post-petition, as well as pursuing an existing lawsuit against the debtor that was filed pre-petition
- Starting administrative proceedings against the debtor
- Pursuing judgments that were obtained pre-petition
- Creating, perfecting or enforcing a lien against property of the estate, even when the right to do so was obtained pre-petition[3]
- Creating, perfecting, or enforcing a lien against the debtor's property that secures any pre-petition debt[4]
- Exercising any kind of control over the debtor's property
- Setting off of any debt against the debtor that arose pre-petition against amounts owed to the debtor
- Unilaterally terminating an executory contract (e.g. a lease) with the debtor

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[3] There are exceptions for certain liens. *See, e.g.*, 11 U.S.C. § 362(b)(18).
[4] *Id.*

Automatic stay: What does it not cover?

The automatic stay is not absolute. There are certain types of actions and exceptions that exist, or that simply do not fall under the purview of the stay. Examples include:

- Pursuit of lawsuits filed by the debtor as a plaintiff – not subject to the stay
    - Not an attempt by a creditor to obtain a recovery from the debtor, or obtain control over property of the estate
- Pursuit of criminal prosecutions[5] (e.g. contract fraud)
- Actions by government agencies relating to their police and regulatory powers[6] (e.g. debarment and suspension proceedings)
- Tax audits and demand for tax returns[7]

Automatic stay: Uncertainty if sure automatic stay applies?

There may be situations where it is unclear whether the automatic stay applies to a course of action a party wishes to take in relation to a debtor. Examples of ambiguous situations include:

- A plaintiff believing that its lawsuit relates entirely to post-petition conduct and thus is not barred by the automatic stay, but the debtor contends the lawsuit is based on pre-petition events
- A creditor believing that it is exercising a right of recoupment (which is not subject to the stay), but the debtor characterizes the action as a setoff (which is subject to the stay)

In the event of uncertainty, a party may wish to file a motion seeking a declaratory statement that the automatic stay does not apply to the anticipated action and, in the alternative, relief from the automatic stay if the court determines the stay does apply.[8]

Automatic stay: When does it stop?

While the stay goes into effect immediately upon the filing of a bankruptcy petition, the stay may no longer apply at certain points during the case. The stay ceases to apply when:

- The debtor's bankruptcy case is closed[9]

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[5] 11 U.S.C. § 362(b)(1).
[6] 11 U.S.C. § 362(b)(4).
[7] 11 U.S.C. § 362(b)(9).
[8] Lawrence Block & Janet Nesse, *A Practical Guide to Bankruptcy & Government Contracts* (2013).
[9] 11 U.S.C. § 362(c)

- The debtor's bankruptcy case is dismissed[10]
- The debtor is granted or denied a discharge of its pre-petition debts[11]
- The Bankruptcy Court grants relief from the stay [12]

Automatic stay: how it arises in government contracts matters

One of the scenarios in which government contract matters often intersect with the automatic stay is in the termination of a contract with the debtor. If a termination is perfected before the debtor files its bankruptcy petition, the automatic stay does not apply. However, short of termination, a debtor would likely contend that the stay applies. That is to say, if the agency has only mailed warning documents such as cure notices or show cause notices, the automatic stay would preclude unilateral termination. Even under a contract with a termination for convenience provision, the government must obtain from the Bankruptcy Court relief from the automatic stay in order to terminate.[13]

Another scenario in which the stay applies is when a prime contractor has filed a bankruptcy petition. A subcontractor attempting to recover funds from the prime contractor, or to terminate the contract or other agreement, would violate the stay.

Other examples include:

- If a prime contractor wishes to terminate a contract with a debtor subcontractor that has not been terminated pre-petition, the prime contractor must seek relief from stay
- If the debtor is in possession of government property, the government must seek relief from stay to recover the property

[10] *Id.*
[11] *Id.*
[12] *See* 11 U.S.C. § 362(d)
[13] Block & Nesse, *supra* n. 8.

Relief from the Automatic Stay

Seeking relief from the automatic stay: pursuing pre-petition rights

If the automatic stay enjoins a creditor or other party in interest from taking certain actions against the debtor or property of the estate, that party may seek an order from the Bankruptcy Court granting it relief from the stay.

Relief from stay is requested by filing a motion with the Bankruptcy Court overseeing the debtor's case, and providing notice to those parties specified by the Federal Rules of Bankruptcy Procedure and the court's local rules. Courts typically require an evidentiary hearing. The stay may be lifted entirely, partially modified, or left in place, but only in respect to the moving party. The Bankruptcy Court granting relief from stay for one party with respect to a particular piece of the debtor's property does not give other creditors the right to pursue that property.

Upon notice and a hearing, the Bankruptcy Court may grant relief from stay by terminating, annulling, modifying, or conditioning the stay:

1. for cause, including the lack of adequate protection for property in which the moving party has an interest, or

2. regarding the stay of an act against property if the debtor has no equity in the property, and the property is not necessary to an effective reorganization[14]

The Bankruptcy Code does not define "cause," so courts interpret this concept on a case-by-case basis. The party requesting relief from the stay has the burden of proof regarding whether the debtor has equity in the property; the party opposing the motion has the burden of proof regarding all other issues.[15]

Adequate protection

The concept of "adequate protection" only applies when a creditor holds a secured claim. The Bankruptcy Code provides that creditors with a secured interest in the debtor's property are entitled to adequate protection.

Adequate protection means preserving the value of the property or collateral securing the creditor's claim – a means of preserving the status quo. For example, adequate protection may be required for the debtor to continue possessing and using the collateral in which the creditor has an interest, or if the debtor wishes to obtain post-petition credit and wants to grant a senior lien on the collateral in order to obtain the credit.

The Bankruptcy Code provides three examples of adequate protection:[16]

1. A single or periodic cash payments to compensate for a decrease in value of the secured creditor's interest in the property

[14] 11 U.S.C. § 362(d)(2).
[15] 11 U.S.C. § 362(g).
[16] 11 U.S.C. § 361.

2. Additional or replacement liens
3. The "indubitable equivalent" of the creditor's interest in the property

Practical tips for addressing automatic stay

1. If there is any uncertainty whether the automatic stay applies to any action a party wishes to take that may be adverse to a debtor, it is good practice to assume the stay applies. Better to err on the side of caution and either (1) get assurance from the Bankruptcy Court that the stay does not apply, or (2) obtain relief from the stay.

2. Unless the Bankruptcy Court's procedures or local rules provide differently, be prepared for a stay relief hearing with witnesses and exhibits. Affidavits and other informal documents will not be accepted. Granting relief from stay is a significant remedy, and courts will deny the motion if the movant does not have sufficient factual support.

Claims By Governmental Units

Police powers exception to the automatic stay

As previously discussed, the automatic stay acts as an immediate injunction halting of all claims against the debtor including collections efforts and most pending litigation claims.[1] However, there are exceptions, including what is as known as the "police powers exception" which applies to the commencement or continuation of certain types of litigation "by a Governmental unit . . . to enforce such Governmental unit's or organization's police and regulatory power, including the enforcement of a judgment other than a money judgment, obtained in an action or proceeding by the Governmental unit to enforce such Governmental unit's or organization's police or regulatory power."[2] The police and regulatory power exception was enacted by Congress in 1978 as a reaction to court decisions that "had stretched the expanded automatic stay to foreclose States' efforts to enforce their anti-pollution laws."[3] Section 362(b)(4) is intended to prevent the bankruptcy court from becoming a "haven for wrongdoers."[4] The House Report explained the scope of Section 362(b)(4):

> "[W]here a governmental unit is suing a debtor to prevent or stop violation of fraud, environmental protection, consumer protection, safety, or similar police or regulatory laws, or attempting to fix damages for violation of such a law, the action or proceeding is not stayed under the automatic stay."[5]

Accordingly, the police power is generally viewed as encompassing the health, safety, or morals of the public and provides and exception to the automatic stay to allow governmental units to enforce their police and regulatory power in order to prevent debtors from using the bankruptcy courts to frustrate necessary governmental functions.[6]

While the exception allows governmental units to enforce such powers by allowing them to seek and obtain certain equitable judgments, the exception is limited in that it does not permit enforcement of money judgments or other remedies which would amount to asserting control over property of the debtor's bankruptcy estate. In other words, a governmental unit may prosecute and even obtain a judgment against a debtor so long as it is in the enforcement of its police or regulatory powers. But, if that judgment requires the debtor to pay money or transfer property to satisfy the judgment, it will likely be subject to the automatic stay.[7] This is in accord with one of the main tenants of the Bankruptcy Code, equality of distribution. Creditors in the same legal class (e.g., unsecured creditors) are generally treated equally for purposes of value distribution. Allowing the government to obtain a judgment in the enforcement of its police powers but staying execution of such judgment puts the government on the same footing as other creditors who have dealt with the debtor in the course of their businesses. To permit the government to enforce a money judgment would effectively elevate the government over other creditors, which is not the intent of the exception.[8]

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[1] 11 U.S.C. § 362.
[2] 11 U.S.C. § 362(b)(4).
[3] *In re First Alliance Mortg. Co.*, 264 B.R. 634, 646 (C.D. Cal. 2001) (citation omitted)
[4] *Id.* at 645.
[5] *Id.* at 656 (quoting H.R. Rep. No. 95-595, at 343 (1977)).
[6] Lawrence Block & Janet Nesse, *A Practical Guide to Bankruptcy & Government Contracts* (2013) (citations omitted).
[7] *Id.* at 222.
[8] *Id.* (citing 3 Collier on Bankruptcy ¶ 362.05[5], 362-63 (16th ed.)).

Notwithstanding a statement by Representative Don Edwards that the exception under 362(b)(4) is intended to be given a narrow construction,[9] courts have not only often interpreted it broadly[10] but, in a more recent trend, have also constrained bankruptcy courts from conducting any subjective analysis of the regulatory action at issue, reasoning that regulatory agencies should not have to defend their regulatory actions in a bankruptcy court.[11]

Courts have adopted three tests to determine whether the actions by a governmental unit fit within this exception to the automatic stay. A suit comes within the regulatory exception if it satisfies any of the tests.

Pecuniary purpose test

The first test is called the "pecuniary purpose test," under which courts "focus on whether the governmental proceeding relates primarily to the protection of the government's pecuniary interest in the debtor's property, and not to matters of public safety.[12] Those proceedings which relate primarily to matters of public safety are excepted from the stay."[13] Some courts, such as the Eighth Circuit, have moved away from this test as being too narrow and have developed instead what is called the "pecuniary advantage test."[14]

Pecuniary Advantage Test

Under this test, "the relevant inquiry is not whether the governmental unit seeks property of the debtor's estate, but rather whether the specific acts that the government wishes to carry out would create a pecuniary advantage for the government vis-à-vis other creditors."[15] This test would allow the government to reduce its claim to a judgment because the entry of the judgment would not automatically change the government's status as a creditor, but it would prohibit enforcement of the judgment, which would give the government an advantage over other creditors.[16]

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[9] *In re First Alliance Mortg. Co.*, 264 B.R. at 646 (quoting H.R.Rep. No. 95-595, at 343 (1977))
[10] *See, e.g., Penn Terra Ltd. v. Dept. of Environmental Resources, Com. of Pa.*, 733 F.2d 267, 273 (3d Cir. 1984) (finding that the scope of Section 362(b)(4) should not be limited because Congress intentionally used the broad term "police and regulatory powers."). Notably, in *Penn Terra*, the debtor argued that an injunction requiring environmental cleanup was akin to the enforcement of a money judgment because it would require the debtor to spend money. The court rejected such a concept, noting that "almost everything costs something." *Id.* at 277-78.
[11] *McCorp Financial, Inc. v. Bd. Of Governors of the Federal Reserve System*, 502 U.S. 32, 40 (1991)
[12] Block & Nesse, *supra*, at 222.
[13] *Id.* (citing *In re Chateaugay Corp.,* 115 B.R. 28, 31 (Bankr. S.D.N.Y. 1988), quoting *In re Commerce Oil Co.*, 847 F.2d 291, 295 (6th Cir. 1988)).
[14] *Id.* (citing *U.S. ex rel. Fullington v. Parkway Hosp., Inc.*, 351 B.R. 280, 283 (E.D.N.Y. 2006), discussing *In re Commonwealth Companies, Inc.*, 913 F.2d 518 (8th Cir. 1990)).
[15] *Id.* (citation omitted).
[16] *Id.* (citation omitted).

Public policy test

The third test is the public policy test, in which courts distinguish between proceedings that adjudicate private rights and those that effectuate public policy. If the proceeding relates primarily to matters of public policy, it will be excepted from the automatic stay.[17]

Thus, if the government were the plaintiff in a *qui tam* action, the court would either apply the pecuniary purpose test or the public policy test to determine whether the stay applied. To the extent that the governmental unit could demonstrate that the action was one that related primarily to public safety or public policy, the action would be excepted from the automatic stay.

Application of the tests

The Third Circuit[18] considered both the pecuniary purpose and public policy tests in determining whether the proceedings qualified for the police power exception to the automatic stay provision. The Court framed its analysis with the purpose of the law at issue, i.e., whether the law was designed to promote public safety and welfare or to effectuate public policy, in which case the exception applies. However, if the purpose of the law is to protect the government's financial interest in the debtor's property or primarily to adjudicate private rights, then the exception is inapplicable. The complementary tests are designed to sort out cases in which the government is bringing suit in furtherance of either its own or certain private parties' interest in obtaining a pecuniary advantage over other creditors.

APPLICATION OF THE POLICE POWERS EXCEPTION TO QUI TAM ACTIONS

Relator Entitlement To Police Power Exception

Private parties bringing *qui tam* actions under the FCA have argued that they are entitled to exert the police powers exception to the automatic stay. The first step in evaluating whether or not a *qui tam* relator is entitled to the benefit of the police-powers exception for many courts is determining whether that litigant can fit within the term "Governmental unit."[19] Not surprisingly, courts often look to the definition of "Governmental unit" in the Bankruptcy Code, where it is defined to mean: "United States; State; Commonwealth; District; Territory; municipality; foreign state; department, agency, or instrumentality of the United States . . . a State, a Commonwealth, a District, a Territory, a municipality, or a foreign state; or other foreign or domestic Government."[20] Applying this definition to the facts of the particular case, courts will focus on the procedural posture and whether the government has decided to intervene in the case. Typical governmental actions that fit within the exception are actions seeking to enjoin violations of fraud, environmental, consumer protection, safety or labor laws.[21]

Bankruptcy courts often base their decisions on whether to grant *qui tam* relators standing under the police power exception upon whether the Department of Justice has chosen (1) to intervene, (2) declined to intervene, or (3) not yet made its intervention decision with respect to the FCA action.[22] The most prudent approach for a *qui tam* relator is to seek relief

[17] *Chateaugay Corp.*, 115 B.R. at 31.
[18] *In re Nortel Networks, Inc.*, 669 F.3d 128 (3d Cir. 2011).
[19] Block & Nesse, *supra*, at 224.
[20] *Id.* (citing 11 U.S.C.A. § 101(27) (2006)).
[21] *Id.* (citing H. Rep. No. 95-595 at 343 (1977)).
[22] *Id.* (citing *U.S. ex rel. Kolbeck v. Point Blank Solutions, Inc.*, 444 B.R. 336 (E.D. Va. 2011)).

from the automatic stay before commencing or continuing any FCA action against the debtor unless the government has intervened.

A. When the Government Has Intervened

Typically, in cases where the government has intervened, the court is likely to find that the action is subject to the police powers exception to the automatic stay.[23]

U.S. ex rel. Fullington v. Parkway Hosp., Inc.[24]

The District Court for the Eastern District of New York in *U.S. ex rel. Fullington*, had to decide whether the automatic stay applied to a *qui tam* action brought under the FCA in which the government had intervened on only one count of the complaint.[25] In that case, a relator commenced a proceeding against a hospital on behalf of the United States pursuant to the *qui tam* provisions of the FCA. The United States intervened with respect to *only one* of the counts in the complaint.[26] Subsequent to the filing of the suit, the hospital filed its petition under Chapter 11 of the Bankruptcy Code, and then filed a motion to stay the FCA litigation. The Court applied both the "pecuniary advantage test" and the "public policy test" in holding that the count in which the government had intervened fit within the police powers exception to the automatic stay and allowed it to proceed to the point of entry of a judgment.[27] Any enforcement of the judgment would be stayed.[28] It held, however, that the counts in which the government had not intervened were not excepted from the automatic stay because the plaintiff, with respect to those counts, was not a "Governmental unit."[29] On this point, the court reasoned that the definition of "Governmental unit" is limited "to actual Government entities and makes no mention of qui tam plaintiffs. . .[A]lthough a qui tam action can certainly be said to be an action 'on behalf' of or 'for' a Governmental unit, it is not an action 'by' a Governmental unit."'[30]

B. When the Government Declines to Intervene

In cases where the government has decided not to intervene, courts generally hold that the action is not entitled to the police powers exception of Section 362(b)(4).

U.S. ex rel. Kolbeck v. Point Blank Solutions, Inc.[31]

In *Point Blank Solutions Inc.*, the Bankruptcy Court for the Eastern District of Virginia held that a *qui tam* FCA action in which the government expressly declined to intervene is not "an action or proceeding by a Governmental Unit" so as to fall within the governmental police powers exception to the automatic stay.[32] Again, relying on the definition of "Governmental unit," the Court reasoned that it does not contain any reference to a private citizen or entity

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[23] *Id.*
[24] *U.S. ex rel. Fullington v. Parkway Hosp., Inc.*, 351 B.R. 280 (E.D.N.Y. 2006)). For a more detailed analysis of *Fullington*, see Block & Nesse, *supra*, at 227-28.
[25] *Id.*
[26] *Id.* at 281.
[27] *Id.* at 290.
[28] *Id.*
[29] *Id.*
[30] *Id.*
[31] *U.S. ex rel. Kolbeck v. Point Blank Solutions, Inc.*, 444 B.R. 336, 339 (E.D. Va. 2011). For a more detailed analysis of *Kolbeck*, *see* Block & Nesse, *supra*, at 227-28.
[32] *Id.*

acting on behalf of the government, which could be read to include a *qui tam* relator in an FCA action. The Court noted that its decision was consistent with the policy underlying the police powers exception to the automatic stay, which is to prevent private parties from using bankruptcy to frustrate the government's necessary functions. This policy was not served by allowing private parties to use the police powers exception in a case in which the government had declined to intervene.[33]

C. When the Government Has Not Yet Made a Decision to Intervene

U.S. ex rel. Doe v. X, Inc.[34]

In *U.S. ex rel. Doe v. X, Inc.*, a *qui tam* action was filed under the FCA against a debtor in bankruptcy.[35] In this case, the government had obtained an extension of it time to intervene but no such decision had yet been made.[36] The Bankruptcy Court for the Eastern District of Virginia held that the action being pursued exclusively by the relators was subject to the police powers exception to the automatic stay and allowed the litigation to continue.[37] The Court reasoned that "the Government receives the lion's share of any amount recovered and retains significant rights over the litigation."[38] Notably, the Court stated that "the United States is a real party in interest *in all* qui tam *suits*," and suggested that the police powers exception to the automatic stay would apply to all *qui tam* actions brought under the FCA regardless of the government's intervention decision.[39] Eleven years later, the Court retreated from this broad view in *Point Blank Solutions Inc.*, as discussed above.

D. Seeking Relief from the Automatic Stay as an Alternative

In instances where it is determined that the police powers exception does not apply to relator actions, that determination is not an absolute bar to commencing or proceeding with the *qui tam* action; rather, it means that the relator will first have to seek and be granted relief from the automatic stay in the bankruptcy court before continuing or commencing its *qui tam* case.

Quit Tam Actions and Discharge

BAPCPA

In 2005, on the heels of Enron's bankruptcy filing and attendant criminal prosecution, Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), eliminating the ability of corporate debtors to obtain comprehensive discharge of all pre-confirmation debts.[40] BAPCPA added subsection (6)(A) to Section 1141(d), the section that previously afforded corporate debtors a comprehensive discharge of all pre-confirmation debts. This represents a significant change in the rights of corporate debtors for complete debt relief

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[33] *Id.* at 342.
[34] *U.S. ex rel. Doe v. X, Inc.*, 246 B.R. 817 (E.D. Va. 2000). For a more detailed analysis of *Doe*, *see* Block & Nesse, *supra*, at 228-29.
[35] Id.
[36] *Id.* at 819.
[37] *Id.* at 821.
[38] *Id.* at 819-820
[39] Id. at 820.
[40] Pub. L. No. 109-8, 119 Stat. 23 (enacted Apr. 20, 2005); *see also* William Hildbold, *Will Section 1141(d)(6) of the Bankruptcy Code Destroy Corporate Chapter 11 Reorganizations by Rendering SEC Claims Non-Dischargeable?*, ABI Law Rev. (Winter 2009).

through the bankruptcy confirmation process. The new section excludes from the automatic discharge any corporate debts incurred as a result of fraud:

> The confirmation of a plan does not discharge a debtor that is a corporation from any debt (A) of a kind specified in paragraph (2)(A) or (2)(B) of section 523 (a) that is **owed to a domestic Governmental unit**, or **owed to a person** as the result of an action filed under sub-chapter III of chapter 37 of title 31 or any similar State statute.[41]

However, the somewhat ambiguous wording of the provision can lead to inconsistent conclusions. For instance, the precise language appears to exempt two kinds of debts from bankruptcy discharge: (1) debts to a domestic governmental unit arising out of fraud (as defined in Section 523(a)(2)(A) and (B)), and (2) debts owed to a person bringing suit under the FCA or similar state statute.

A. Debts to a Domestic Governmental Unit Arising Out of Fraud (as Defined in Section 523(a)(2)(A) and (B)).

The reference to Section 523(a)(2)(A) and (2)(B) in the provision is a potentially significant qualification.[42] While Section 523(a)(2)(A) does not specifically require reliance (reasonable or otherwise), the U.S. Supreme Court has interpreted Section 523(a)(2)(A) and (2)(B) as requiring *actual fraud* before a debt can be deemed nondischargeable under these provisions.[43] Accordingly, by expressly referring to a debt "of a kind specified in paragraph (2)(A) or (2)(B) of section 523(a)," the provision appears to require that a debt owed to a domestic government unit must be the product of actual fraud before it will be held nondischargeable. The FCA, on the other hand, only requires a showing that the defendant presented a claim "knowing" it was false or fraudulent, and defined "knowing" as including a defendant's "actual knowledge," "deliberate ignorance" or "reckless disregard of the truth of information in the defendant's claim,"[44] a meaningfully lesser standard.

B. Debts Owed to a Person as the Result of an Action Filed Under Sub-Chapter III of Chapter 37 of Title 31 or Any Similar State Statute.

The reference to "subchapter III of chapter 37 of title 31" – the FCA – suggests that Congress intended to exclude from discharge any debt owed to the government arising from a corporation's violation of the FCA. But the plain language used in Section 1141(d)(6)(A) exempts only FCA debts "owed to a person," and not those owed to a "domestic governmental unit." The use of the term "person" in the clause of Section 1141(d)(6)(A) suggests that only

[41] 11 U.S.C. § 1141(d)(6)(A) (emphasis added).
[42] These provisions provide that a discharge is not available from any debt "for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by ... (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition; [or] (B) use of a statement in writing ... (i) that is materially false; (ii) respecting the debtor's or an insider's financial condition; (iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and (iv) that the debtor caused to be made or published with intent to deceive ...." 11 U.S.C. § 523(a)(2)(A) and (B).
[43] *U.S. ex rel. Hefner v. Hackensack Univ. Med. Cen.*, 495 F.3d 103, 109 (3d Cir. 2007).
[44] 31 U.S.C. §3729(b).

debts "owed" to a *qui tam* plaintiff are nondischargeable under this provision of BAPCPA.[45] Notably, "person" is defined in the Bankruptcy Code to specifically exclude any governmental unit.[46] However, as is common knowledge for government contract attorneys, debts resulting from the underlying FCA liability are never "owed" to a *qui tam* plaintiff. Rather, damages are awarded to the government, which then gives a portion of the award to the *qui tam* plaintiff.[47] Even in the context of a non-intervened *qui tam* action, the action is brought in the name of the United States and the judgment rendered would be in favor of the United States, which would in turn pay the relator.

While there is no corresponding section that applies to Chapter 7 (available for individual debtors and corporate debtors) and Chapter 13 (available only for individual debtors) cases, the government or *qui tam* plaintiffs can seek to have an award under the FCA declared nondischargeable under either Section 523(a)(2) which excepts from discharge claims based upon "false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition."[48] Successful FCA plaintiffs could also seek to have the debt declared nondischargeable under Section 523(a)(7) which excepts debts for "a fine, penalty, or forfeiture payable to and for the benefit of a Governmental unit [which] is not compensation for actual pecuniary loss" other than certain tax penalties. This was attempted in *In re Winters*, where the debtor was previously a defendant in a civil FCA action in which the federal government had obtained a $1.8 million civil judgment and $10,000 in civil penalties against him. Because the government had not filed its dischargeability complaint timely, and the debtor died before the litigation was resolved, court did not reach the merits of the Section 523(a)(2) claim,[49] although the court did conclude that the penalties were nondischargeable under Section 523(a)(7) as a matter of law.

Debtor as relator

There may be cases in which the debtor who files a bankruptcy case is a relator. In that case, the claim should be listed as a "cause of action" in Schedule B (where a debtor must list all personal property.) If the government has intervened, then the case information should be listed in the Statement of Financial Affairs. Any recovery would be property of the bankruptcy estate. The automatic stay would not apply as the *qui tam* action is not an action against the debtor.[50]

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[45] Pursuant to 31 U.S.C. § 3730(d)(1), the only "person" that is entitled to any funds as a result of an FCA action is a *qui tam* relator.
[46] 11 U.S.C. § 101(41) ("[t]he term 'person' includes individual, partnership, and corporation, but does not include governmental unit...").
[47] James B. Helmer, Jr., *False Claims Act: Whistleblower Litigation 767* (5th ed. 2007) ("The private right of recovery created by the *qui tam* provisions of the FCA exists not to compensate the *qui tam* relator, but the United States.")
[48] Block & Nesse, *supra*, at 229-30.
[49] *Id.* (citing *In re Winters,* 2006 WL 3833921 (Bankr. W.D. Tenn. 2006)).
[50] Block & Nesse, *supra*, at 230.

Judge Thomas J. Catliota
United States Bankruptcy Court
District of Maryland

Setoff/Recoupment

Setoff and recoupment are important defenses that the government may raise in a bankruptcy proceeding.

Setoff

- The right of setoff "allows entities that owe each other money to apply their mutual debts against each other, thereby avoiding 'the absurdity of making A pay B when B owes A.'" *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 18 (1995) (quoting *Studley v. Boylston Nat. Bank*, 229 U.S. 523, 528 (1913)).
- Section 553 of the Bankruptcy Code preserves a creditor's nonbankruptcy right "to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case . . . ." 11 U.S. C. §553(a). A creditor wishing to apply the right of setoff must show: (1) that the debtor owes a pre-petition debt to the creditor; (2) that the creditor owes a pre-petition debt to the debtor; and (3) the debts are mutual. *See Alexander Properties, L.L.C. v. Patapsco Bank*, 883 F.Supp. 2d 552, 556 (D. Md. 2012). To apply the right of setoff, a creditor must first seek relief from the automatic stay. *See In re Strumpf*, 37 F.3d 155, 157 (4th Cir. 1994), *rev'd on other grounds*, 516 U.S. 16 (1995).
- The government is considered a single creditor for the purposes of setoff. *See U.S. v. Maxwell*, 157 F.3d 1099, 1100 (7th Cir. 1998). Outside of the bankruptcy context the United States has a right to setoff and the bankruptcy code does not modify this right.

- To assert a claim against a bankruptcy estate, it is generally necessary to file a proof of claim. Nothing in 11 U.S.C. A. §553 requires a creditor to assert a right of setoff in a proof of claim to preserve its right. However, courts are divided on whether a creditor may waive a setoff for failure to assert a right of setoff in a proof of claim. Compare *In re Calore Exp. Co., Inc.*, 288 F.3d 22, 39, 48 (1st Cir. 2002) (proof of claim not prerequisite to retention of setoff right); and *Bloor v. Shapiro*, 32 B.R. 993, 1002 (S.D.N.Y. 1983) (holding that a setoff was permissible even in absence of timely filed proof of claim); with *In re Village Craftsman, Inc.*, 160 B.R. 740, 748 (Bankr. D.N.J. 1993) (setoff waived when creditor files unsecured proof of claim and does not object to unsecured treatment in plan of reorganization); and *In re L.P. Britton*, 83 B.R. 914 (Bankr. E.D.N.C. 1994) (holding that creditor waived its right to setoff by filing proof of claim without asserting right to setoff).

Recoupment

- The common-law doctrine of recoupment provides a means for a creditor to abate or reduce a claim that the debtor has against the creditor that arose from the same transaction which establishes a claim that the creditor has against the debtor. *See In re Powell*, 284 B.R. 573, 576 (Bankr. D. Md. 2002).
- In essence, the doctrine of recoupment is a defense against the debtor's claim against the creditor and therefore may be applicable even where setoff is not available under 11 U.S.C. §553. *Lee v. Schweiker*, 739 F.2d 870, 875 (3rd Cir. 1984). This equitable doctrine is treated as a non-statutory exception to the automatic stay in many courts because the "right of recoupment does not

constitute a debt which is dischargeable. *In re Powell*, 284 B.R. at 576 (quoting *Aetna Life Ins. Co. v. Bram*, 179 B.R. 824, 827 (Bankr. E.D. Tex. 1995)).

- In order for the recoupment doctrine to be applied, "both debts must arise out of a single 'integrated transaction' such that it would be inequitable for the debtor to enjoy the benefits of that transaction without also meeting its obligations." *Id.* (quoting *University Med. Ctr. V. Sullivan*, 973 F.2d 1065, 1081 (3d Cir. 1992)); *United Structures of America, Inc. v. G.R.G. Engineering, S.E.*, 9 F. 3d 996, 999 (1st Cir. 1993) (stating that recoupment allows a view of the transaction as a whole and that "allowing the creditor to recoup damages simply allows the debtor precisely what is due when viewing the transaction as a whole").

The Anti-Discrimination Clause

- In *Perez v. Campbell*, the Supreme Court of the United States held that the provision of a state act that provided that a discharge in bankruptcy did not relieve an individual from having his driver's license and registration suspended if he fails to satisfy a judgment entered against him in an action arising out of the operation of a motor vehicle was invalid under the supremacy clause of the United States Constitution. 402 U.S. 637, 639 656 (1971). Following the Supreme Court's decision in *Perez*, Congress incorporated the holding into the bankruptcy law by including §525(a) within the bankruptcy code. Lawrence Block & Janet Nesse, A Practical Guide to Bankruptcy & Government Contracts §5:2 at 188 (2013); H.R. Rep. No. 595, 95th Cong., 1st Sess. 366–67 (1977); S.Rep. No. 989, 95th Cong., 2d Sess. 81 (1978), U.S. Code Cong. & Admin. News 1978, p. 5787.

- Section 525(a) of Title 11 of the United States Code provides:

  > Except as provided in the Perishable Agricultural Commodities Act, 1930, the Packers and Stockyards Act, 1921, and section 1 of the Act entitled "An Act making appropriations for the Department of Agriculture for the fiscal year ending June 30, 1944, and for other purposes," approved July 12, 1943, a governmental unit may not deny, revoke, suspend, or refuse to renew a license, permit, charter, franchise, or other similar grant to, condition such a grant to, discriminate with respect to such a grant against, deny employment to, terminate the employment of, or discriminate with respect to employment against, a person that is or has been was debtor under this title or a bankrupt or a debtor under the Bankruptcy Act, or another person with whom such a bankruptcy or debtors has been associated, solely because such bankrupt or debtor is or has been a debtor under this title or a bankrupt or debtor under the Bankruptcy Act, has been insolvent before the commencement of the case under this title, or during the case but before the debtor is granted or denied a discharge, or has not paid a debt that is dischargeable in the case under this title or that was discharged under the Bankruptcy Act.

  11 U.S.C.A. §525(a).

- Section 525(a) protections apply to debtors under all chapters of the Bankruptcy Code, but does not apply to those who may file a bankruptcy in the future. Block & Nesse, *supra*, at 189. The language of the statute also applies to "another person with whom such a bankruptcy or debtors has been associated." 11 U.S.C. §525(a). At least one court has held that this language includes an entity that purchases a debtor's assets through a court-approved sale pursuant to section 363 of the Bankruptcy Code. *See In re Betty Owen Schools, Inc.*, 195 B.R. 23, 28 (Bankr. S.D. N.Y. 1996).

- With certain limited exceptions, §525(a) is focused on discrimination from governmental units which has been interpreted broadly to include governmental

agencies, states, governmental corporations or entities where a state's interest is entangled with the entity and governmental officials. *See e.g., F.C.C. v. NextWave Personal Communications, Inc.*, 537 U.S. 293 (2003) (applying the anti-discrimination clause to the Federal Communications Commission); *Matter of Son-Shine Grading, Inc.*, 27 B.R. 693 (Bankr. E.D. N.C. 1983) (holding that the Department of Transportation for the State of North Carolina could not discriminate against former debtor); *Matter of Haffner*, 25 B.R. 882 (Bankr. N.D. Ind. 1982) (holding that the anti-discrimination clause applied to the Commodity Credit Corporation, a corporation under governmental control); *New Baltimore Towers v. Oksentowicz*, 2005 U.S. Dist. LEXIS 20258 (E.D. Mich. Sept. 16, 2005) (holding that a federally subsidized apartment complex was a governmental unit subject to §525(a) because of its "entwinement with governmental policies, management, or control . . . ."); *In re Potter*, 354 B.R. 301 (Bankr. N.D. Ala. 2006) (denying summary judgment and holding that, in the light most favorable to the non-moving party, a city council decision to replace a police chief who filed a bankruptcy petition implicated §525(a)).

- While §525(a) does not apply to purely private parties, §525(b) provides that a private employer may not discriminate "with respect to employment." 11 U.S.C. §525(b); s*ee Brown v. Pennsylvania State Employees Credit Union*, 851 F.2d 81, 85 (3d Cir. 1988) ("Section 525 bars only governmental agencies and employers from discriminating against a debtor on account of a previous bankruptcy filing."). Some courts have held that anti-discrimination applies to current employees, while other courts have interpreted §525(b) to include prospective job

applicants. Compare *Rea v. Federated Investors*, 627 F.3d 937, 938, 940–41 (3d Cir. 2010) (upholding the bankruptcy court's decision that §525(b) did not create a cause of action against a private employer engaged in discriminatory hiring); with *Leary v. Warnaco, Inc.*, 251 B.R. 656, 658 (S.D.N.Y. 2000) (holding that §525(b) extends to discrimination "with respect to extending an offer of employment."). At least one court has also extended protections under §525(b) to long-term independent contractors. *See Matter of McNeely*, 82 B.R. 628, 632 (S.D. Ga. 1987) (stating that the "better view of Section 525(b) recognizes that Congress included all private employment relationships in the anti-discrimination provisions.").

- The protections from discrimination under §525 are understood broadly. The Supreme Court has expanded the interpretation of §525 to include denial of licenses or bids where the proximate cause is the debtor's failure to make payments that were due. *See F.C.C. v. NextWave Personal Communications, Inc.*, 537 U.S. 293, 300 (2003). However, the protections are not without limits. Discrimination is not barred by §525 under the auspices of particular statutes. *See* 11 U.S.C. 525(a) (excluding the Perishable Agricultural Commodities Act, the Packers and Stockyards Act and section 1 of "An Act making appropriations for the Department of Agriculture for the fiscal year ending June 30, 1944"). Furthermore, to be protected under §525, the privilege that a debtor is seeking to protect must fit within one of the enumerated categories set forth in §525. Whether the privilege fits within a category can often turn on whether the court interprets §525 broadly or narrowly, but under either interpretation the

discrimination at issue must relate in some way to "property interests are unobtainable from the private sector and essential to a debtor's fresh start." *See In re Stoltz*, 315 F.3d 80, 90 (2d Cir. 2002).

The Anti-Discrimination Clause and Security Clearances

- Particularly relevant to governmental employees is the effect of a bankruptcy on an employee's ability to get a security clearance. A security clearance is official permission for an individual to access classified information or restricted areas. The more classified the information, the more difficult it is to obtain clearance. Block & Nesse, *supra*, at 195. A security clearance is essential for many governmental positions. *Id.* The United States Supreme Court has held that the Executive Branch has substantial discretion in regulating access to information pertaining to national security stating that "no one has a 'right' to a security clearance." *Dept. of the Navy v. Egan*, 484 U.S. 518, 528 (1988).
- To acquire a security clearance, the government vets the individual through a background check and gathers information within thirteen guidelines.[1] A disqualifying condition within any of the thirteen areas will result in a denial of the clearance unless there is evidence of mitigation.
- Of particular relevance here is the guideline entitled "Financial Considerations." Block & Nesse, *supra*, at 195. Bankruptcy is not specifically listed among the considerations in Guideline F, but consideration of an "individual's inability or unwillingness to satisfy debts" and as well as "a history of not meeting financial

[1] The Guidelines are contained within the Revised Adjudicative Guidelines (the "AG"), approved by the President on December 29, 2005, which were implemented by the Department of Defense on September 1, 2006. The revised Adjudicative Guidelines supersede the guidelines listed in Enclosure 2 to the Directive, and they apply to all adjudications or trustworthiness determinations in which a statement of reasons was issued on or after September 1, 2006.

obligations." AG¶¶19(a) and 19(c). Therefore, it is generally the circumstances that could lead to a bankruptcy, and not the bankruptcy itself, which are weighed under Guideline F. *See, e.g., In the matter of Applicant for Security Clearance*, ISCR 08-03413 (DOHA Mar. 31, 2009). These considerations are relevant to an individual's reliability and vulnerability to coercion from being financially overextended. Block & Nesse, *supra*, at 196. As there is a presumption against granting a security clearance, debtors should proactively seek to demonstrate mitigating factors when being reviewed following a bankruptcy. *Id.*

GOVERNMENT CONTRACTS – ISSUES RELATING TO ASSUMPTION AND ASSIGNMENT IN CHAPTER 11 CASES

It's obvious: a government contract or a number of government contracts can be extremely valuable to a debtor's business. Indeed, a government contract can be the backbone of a particular business. That is why it is so important for anyone representing a debtor that has government contracts – or anyone lending to a debtor whose business depends on government contracts – to consider the effect of bankruptcy on government contracts *before* the debtor files for Chapter 11 relief. For the purpose of this outline, we will focus on contracts with the federal government.[1]

Executory Contracts and the Bankruptcy Code

The United States Bankruptcy Code, 11 U.S.C. §§ 101 et. seq., has special provisions relating to "executory contracts." The term "executory contract," while critically important, is not defined in the Code. Rather, the meaning of the term has been developed over the years, and oftentimes refers to a contract on which performance, other than the payment of money, is due from both parties to the contract.[2]

A Chapter 11 debtor-in-possession[3] has three options with respect to executory contracts: it can assume them,[4] assume and assign them, or it can reject them. A contract that is not assumed or assumed and assigned in a bankruptcy case is deemed to have been rejected.[5] In a Chapter 11 case, a debtor has until confirmation of its reorganization plan to assume, assign, or reject a contract.[6]

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[1] Some of the issues discussed in this outline apply also to contracts with other governmental units, such as states. See generally *In re Nitec Paper Corp.*, 43 B.R. 492, 498 (S.D.N.Y. 1984)(debtor could not assign non-delegable rights under contract with Niagara-Mohawk Power Corporation, a subdivision of the State of New York).

[2] Many courts look to the explanation of Professor Vern Countryman, who explained that an executory contract is a "contract under which the obligation of both the bankrupt and the other party to the contract are so unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other." Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 Minn. L. Rev. 439, 460 (1973). *See also Lewis Bros. Bakeries Inc.v. Interstate Brands Corp. (In re Interstate Bakeries Corp.)*, 751 F.3d 955, 962 (9th Cir. 2014)("This circuit has adopted Professor Countryman's definition of an executory contract for purposes of the Bankruptcy Code"); *In re Exide Techs.*, 607 F.3d 957, 962 (3d Cir. 2010)("With Congressional intent in mind, this Court has adopted the [Countryman] definition"); *Olah v. Baird (In re Baird)*, 567 F.3d 1207, 1211 (10th Cir. 2009)(formally adopting Countryman approach); *Nw. Airlines Inc. v. Klinger (In re Knutson)*, 563 F.2d 916, 917 (8th Cir. 1977)(adopting Countryman definition of executory contract). Other courts apply a slightly different functional approach that considers whether assumption of the contract would benefit the estate. *See., e.g., Chattanooga Mem'l Park v. Still (In re Jolly)*, 574 F.2d 349, 350-351 (6th Cir. 1978)(criticizing rigid application of Countryman approach).

[3] Typically, a trustee is not appointed in a Chapter, but rather the debtor continues to run its business and is referred to as the "debtor in possession." 11 U.S.C. §101 13); 11 U.S.C. § 1101(1). Even though a debtor in possession typically stays in charge of its case, a trustee can be appointed for cause or if the appointment is in the interest of stakeholders. 11 U.S.C.§ 1104.

[4] Certain types of executory contracts may not be assumed, including contracts to make a loan or a contract to extend other financial accommodations to the debtor. 11 U.S.C. § 365(c)(3).

[5] For that reason, many bankruptcy reorganization plans include a provision to the effect that all executory contracts that have not been rejected in the case are deemed to have been assumed. The plan can provide for

Assumption: When a debtor assumes a contract, it agrees to be bound by the contract post-bankruptcy.[7] Should it fail to perform on the contract, damages for breach of contract will be entitled to administrative priority, and will be paid before general unsecured creditors.[8] In order to assume a contract, a debtor must cure or provide adequate assurance that it will cure damages arising under the contract, it must provide to compensate the non-debtor for actual pecuniary loss under the contract, and it must give adequate assurance of future performance under the contract.[9]

Assignment: When a debtor assigns a contract, it is no longer liable for damages under the contract going forward, nor is it obligated to perform on the contract going forward.[10] Rather, the third party to whom the contract has been assigned is liable on the contract and has the ability to benefit from the contract.

Rejection: If the debtor rejects a contract, the damages for rejection typically are pre-petition claims, which, unless they are secured or entitled to one of the relatively few priorities, are entitled only to be paid as general pre-petition claims,[11] on which there may be little, if any, distribution. There is some disagreement in the case law these days about the effect of rejection on some types of contracts,[12] but there is general agreement that post-rejection, the benefits of the contract are unavailable to the debtor.

If a debtor neither assumes nor rejects a contract, the contract is deemed rejected. Of course, the non-debtor party to the contract may decide not to treat the debtor's failure to assume the contract as a rejection if the debtor accidentally failed to assume the contract.

In order for a debtor to assume, assign, or reject a contract, the debtor-in-possession – or trustee if one has been appointed - must obtain court approval.[13] This approval is ***usually*** relatively easy to obtain: courts generally consider whether the contract's assumption, assignment, or rejection is in the best interest of the estate.[14] Unless there is something unusual going on (such as a case involving a

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rejection of unassumed contracts as a default, but that can be risky if the debtor has not undertaken extremely careful diligence of its executory contracts. Code section 1123(b)(2) specifically provides that:

> Subject to section 365 of this title, [a plan may] provide for the assumption, rejection, or assignment of any executor contract or unexpired lease of the debtor not previously rejected under such section. . .

[6] 11 U.S.C. § 365(a)(d)(2).

[7] A contract must be assumed as a whole and may not be assumed in part. *In re Buffets Holdings, Inc.,* 387 B.R. 115 (Bankr. D. Del. 2008)(leases governed by master lease were not divisable).

[8] 11 U.S.C. § 365(g)(2).

[9] 11 U.S.C. § 365(b).

[10] 11 U.S.C. § 365(k)("Assignment by the trustee to an entity of a contract or lease assumed under this section relieves the trustee and the estate from any liability for any breach of such contract or lese occurring after such assignment").

[11] 11 U.S.C. § 365(g)(1).

[12] *See Sunbeam Prods. V. Chi. Am. Mfg., LLC,* 686 F.3d 373 (7th Cir. 2012)(breach of trademark license does not terminate the contract) and cases cited therein.

[13] Fed. R. Bankr. P. 6006 (executory contracts are subject to the rules relating to contested matters); Fed. R. Bankr. P. 9014 (providing rules applicable to contested matters).

[14] *E.g., Orion Pictures Corp. v. Showtime Networks (In re Orion Pictures Corp.),* 4 F.3d 1095, 1099 (2d Cir. 1993) (the question is whether assuming the contract would be beneficial or burdensome to the estate).

contract with an entity controlled by insiders of the debtor), the courts defer to the business judgment of the debtor,[15] so long as the debtor can give adequate assurance of future performance and cure defaults. Typically, the assumption, assignment or rejection of a contract will occur as a result of a contested motion filed with the court, although Chapter 11 debtors-in-possession may provide in their reorganization plans that contracts that have been neither assumed nor rejected will all be deemed to have been assumed or will all be deemed to have been rejected.[16]

Limitations on Assumption and Assignment in the Bankruptcy Code

However, there are certain contracts that are not subject to assumption or assignment. Most courts hold that these are contracts that, under applicable non-bankruptcy law, are not assignable because they are not assignable under applicable non-bankruptcy law even if they do not explicitly contain a non-assignability provision. The category of non-assignable contracts includes personal service contracts (such as Picasso's contract to paint your portrait, which he could not have assigned to Jackson Pollack[17]), but also other contracts that are not assignable for some reason other than the mere presence of language in the contract providing that it is unassignable. On this point, however, the legal issues become muddy because the statute is unclear: there are two subsections of section 365, section 365(c)(1)(A) and section 365(f), that many courts struggle to reconcile.

Section 365(c)(1)(A) provides:

> (c) The trustee **may not** assume or assign any executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment or rights or delegation of duties, if –
>
> > (1)(A) **applicable law** excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and
> >
> > (B) such party does not consent to such assumption or assignment . . .(emphasis added).

Standing alone, this section of the Code seems to state that the trustee cannot assume or assign an executory contract if applicable law excuses a third party from accepting performance from or rendering performance to a debtor in possession. It also appears to suggest (less clearly) that a provision in a contract providing that the contract is non-assignable is not, by itself, sufficient to block the assumption or assignment of the contract by the debtor in possession. Courts have pretty much

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[15] *See, e.g., Bildisco v. Bildisco*, 465 U.S. 513, 523 (1984)(general test under Code section 365 regarding assumption or rejection of executory contracts is the business judgment test); *Durkin v. Benedor Corp. (In re G.I. Indus., Inc.)*, 204 F.3d 1276, 1282 (9th Cir. 2000)(business judgment test used to evaluate decision to reject contract).

[16] 11 U.S.C. § 1129(a)(standards for confirmation of a reorganization plan).

[17] Farnsworth, *§* 11.10 at 744-45 (3d ed. 1999)(explaining that neither a painter nor a singer can delegate their performance even to a painter or singer who is arguably superior).

agreed that a non-assignability clause will not, by itself, bar a debtor in possession from assuming a contract.[18]

There is, however, another subsection of the Code that muddies the water: Code section 365(f)(1). It clearly states that a non-assignability provision in a contract will not, by itself, render the contract non-assumable in bankruptcy. However, the section also contains language that seems to be inconsistent with Code section 365(c)(1)(A). Section 365(f)(1) provides:

> (f)(1) Except as provided in subsections (b) and (c) of this section, notwithstanding a provision in an executory contract or lease of the debtors, or in **applicable law** that prohibits, restrict, or conditions the assignment of such contract or lease, the trustee **may** assign such contract or lease under paragraph (2) of this subsection.

In other words, Code section 365(c)(1) appears to allow "applicable law" to bar a debtor from assuming and assigning a contract, while Code section 365(f)(1) appears to specifically allow a debtor to assign a contract, even if applicable law would prohibit the assignment. The dueling language has led some courts to conclude that the Code is just inconsistent.[19]

How have the courts dealt with this apparent inconsistency? An early case holding that non-bankruptcy anti-assignment law limited a debtor's ability to assign a contract was the First Circuit Court of Appeals in the case *In re Pioneer Ford Sales, Inc.*[20] There, the court interpreted two subsections of Code section 365, sections 365(c)(1)(A) and 365(f)(1), and held that because state franchise law provided that automobile dealership franchise agreements were not assignable, the debtor could not assign a Ford dealership franchise to another entity.[21]

The *Pioneer Ford* court reached this conclusion by reading the phrases "applicable law" in 365(c)(1)(A) and 365(f) to have a different meaning: according to the *Pioneer Ford* court, the first reference to applicable law refers to non-bankruptcy laws barring assignment even if the contract is silent on the issue of assignability. By contrast, 365(f) applies to non-bankruptcy laws that give effect to an anti-assignment provision in a contract.[22]

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[18] 11 U.S.C. § 365(f)(1).

[19] *E.g., Breeden v. Cantron (In re Catron)*, 158 B.R. 629, 637 (E.D. Va. 1991)(noting that the statute "simply cannot be reconciled").

[20] 729 F.2d 27, 29 (1st Cir. 1984).

[21] Many courts have followed this logic. For example, in *Rieser v. Dayton Country Club Co. (In re Magness)*, 972 F.2d 689, 695 (6th Cir. 1992), the Sixth Circuit Court of Appeals held that golf club memberships could not be assumed and assigned to third parties, holding that the prohibition of an assumption under "applicable law" in Code section 365(c)(1)(A) gave effect to the Ohio law that would enforce provisions in the membership agreements prohibiting assignment because the identity of the members was material to the contract. *Accord Stumpf v. McGee (In re O'Connor), 258 F.3d 392, 402 (5th Cir. 2001)(under applicable Louisiana law, partnership agreement could not be assumed in light of section 365(c)(1)); RCI Tech. Corp. v. Sunterra Corp. (In re Sunterra Corp.)*, 361 F.3d 257, 266 (4th Cir. 2004); *City of Jamestown v. James Cable Partners, L.P. (In re James Cable Partners, L.P.)*, 27 F.3d 534, 538 (11th Cir. 1994).

[22] *In re Pioneer Ford Sales, Inc.*, 729 F.2d 27, 29 (1st Cir. 1984).

Following the logic of cases such as *Pioneer Auto Sales*, many courts look to the federal Anti-Assignment Act,[23] however, and hold that a debtor-in-possession cannot assign a federal contract to a third party without court approval or without the consent of the government. For that reason, a debtor that seeks to assign its government contracts to a third party in connection with a sale of assets must allow time to obtain any requisite governmental consents to the assignment.

A leading case applying this rule is *In re Carolina Parachute Corp*.[24] There, the district court, relying on the Anti-Assignment Act, held that a contract to manufacture parachutes for government use could not be assigned to a third party in light of the language of 11 U.S.C. § 362(c)(1) and the Anti-Assignment Act. Many courts have followed this reasoning.[25]

Many lawyers would consider the rule that governmental contracts are not assignable in light of the Anti-Assignment Act to be reasonable and not grossly unfair. After all, the rule that a contract can be assigned in bankruptcy even if it includes an anti-assignment clause that is enforceable outside of bankruptcy is an exception to the general rule of freedom of contract. It is a special benefit that debtors (and, secondarily, their creditors) receive in bankruptcy. Moreover, the Anti-Assignment Act is a federal statute entitled to the same deference by the courts as is the Bankruptcy Code. Accordingly, both statutes can be given effect by courts holding that the Anti-Assignment Statute is not abrogated by the Bankruptcy Code.

Effect on a Debtor in Possession That Does Not Seek Assignment

There is, however, an interpretation of the Bankruptcy Code that has been adopted by a number of circuits and some lower courts that some might find to be problematic or even shocking: that is the rule that because the Anti-Assignment Act provides that government contracts are not assignable, they cannot even be *assumed* by a Chapter 11 debtor in possession. The reasoning of these courts is that the debtor-in-possession is not the same entity as the pre-petition debtor and thus the assumption of a contract by a debtor-in-possession violates the Anti-Assignment Act.

This interpretation has been referred to by commentators and some courts as the "hypothetical test." The leading case articulating this reasoning is the *West Electronics* case from the Third Circuit, in which a divided panel held that a debtor-in-possession could not assume a government military equipment supply contract. The court rested its reasoning on two grounds. First, it noted that Code section 365(c)(1) provides that a debtor cannot assume *or* assign a contract that is non-assignable under applicable law, stressing that Congress had included the term "or the debtor in possession" in Code

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[23] 41 U.S.C. § 15. This section provides in part:

> No contract or order, or any interest therein, shall be transferred by the party to whom such contract or order is given to any other party, and any such transfer shall cause the annulment of the contract or order transferred, so far as the United States is concerned. All rights of actions, however, for any breach of such contract by the contracting parties, are reserved to the United States.

[24] *United States Dep't of Air Force v. Carolina Parachute Corp. (In re Carolina Parachute Corp.)*, 108 B.R. 100 (M.D.N.C. 1989), *aff'd in part, vacated in part, United States Dep't of Air Force v. Carolina Parachute Corp.*, 907 F.2d 1469 (4th Cir. 1990).

[25] E.g., *In re West Elecs. Inc.*, 852 F.2d 79, 83 (3d Cir. 1988)(debtor could not assume government contract providing that it supply the government with military equipment).

section 365(c)(1) to address a situation in which the debtor remains in possession of its assets, even if it does not attempt to assign the contract to a third party. Second, it stressed that an insolvent debtor-in-possession is not the same entity as the solvent entity with which the government contracted. Unfortunately for entities that have to file for bankruptcy, this is a terrible result: it basically means that, unless the government consents, the government can force the termination of a contract if the debtor files for bankruptcy in a circuit that has this rule and this termination will occur even if the debtor does not attempt to assign the contract to a third party.

How did the Third Circuit reach this conclusion? Basically, it strove to construe opaque and inconsistent statutory language and reached a result that many have criticized. The important underpinning of this decision, however, was based on the theory that the entity in Chapter 11 is a different legal entity from the pre-Bankruptcy debtor. The court reached this conclusion because, upon the filing of a Chapter 11 case, the debtor becomes a "debtor in possession": an entity that has most of the powers and duties of a Chapter 11 trustee.[26] In addition, the debtor in possession (called in the jargon of the trade, a "DIP") has additional duties, including marshaling assets and managing the estate in the best interest of creditors, that a debtor would not have. Despite widespread criticism of the case, a number of circuits have adopted the Third Circuit's interpretation of Code section 365(c)(1) and held that a debtor-in-possession may not assume a contract that is non-assignable under non-bankruptcy law.[27]

Other circuits disagree or have not yet determined the issue. Cases in those circuits generally reason that, while a debtor-in-possession may not be able to assume and assign a government contract, a debtor-in-possession is the same entity as the debtor and thus the Anti-Assignment Act does not prohibit the assumption of the contract by the Chapter 11 debtor.[28]

A leading case espousing this view is *Bonneville Power Admin. V. Mirant Corp. (In re Mirant Corp.)*.[29] In *Mirant,* the debtor had entered into a contract for the future purchase of electrical energy with the Bonneville Power Administration ("BPA"), which, the Fifth Circuit Court of Appeals explained, is a

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[26] 11 U.S.C. § 1107.
[27] *See In re James Cable Partners, 27 F.3d 435, 537(11th Cir. 1994); In re Sunterra Corp.*, 361 F.3d 257, 267 (4th Cir. 2004)(stressing that Code section 365(c)(1) addresses both assumption and assignment); *Perlman v. Catapult Entm't, Inc. (In re Catapult Entm't, Inc.)*, 165 F.3d 747, 750 (9th Cir. 1999)(relying on plain language of Code section 365(c)(1)('the statute by its terms bars a debtor-in-possession from assuming an executor contract without the nondebtor's consent where applicable law precludes assumption of the contract to a third party').
[28] *See, e.g.,Summit Inv. & Dev. Corp. v. Leroux, 69 F.3d 608, 613 (1st Cir. 1995); Institut Pasteur v. Cambridge Biotech Corp.*, 104 F.3d 489, 493 (1st Cir. 1997) and cases cited therein; *see also, In re Cardinal Indus. Inc.*, 116 B.R. 964, 982 (Bankr. S.D. Ohio 1990)(because performance will be rendered by the same entity that was party to the non-assignable contract prepetition, a debtor for which an operating Chapter 11 trustee has been appointed may assume a contract that is non-assignable under applicable non-bankruptcy law; sophisticated discussion of legislative history)(the author was counsel to the Chapter 11 trustee in the *Cardinal Industries* case); *In re Ontario Locomotive & Indus. Ry. Supplies, Inc.*, 126 B.R. 146, 148 (Bankr. W.D.N.Y. 1990)(rejecting hypothetical test).
[29] 440 F.3d 238 (5th Cir. 2006).

"federal power marketing agency within the United States Department of Energy."[30] BPA sought to terminate the contract, relying of the cases applying the hypothetical test.

The Fifth Circuit rejected that argument. In so doing, it looked to the statute's language, focusing especially on Code section 365(e)(1) and rejecting the argument that 11 U.S.C. § 365(c)(1) controlled, with its reference to a debtor in possession.[31] Rather, it reasoned that Code section 365(e)(1) required an actual, rather than hypothetical test, and that the Non-Assignment Act also suggested that a case by case analysis was appropriate in determining the effectiveness of an the law.[32]

In determining whether the automatic stay applied, the Fifth Circuit made another critically important point: the federal government could choose to waive the provisions of the act. The court explained:

> The Anti-Assignment Act . . . provides the government with an option to rescind is contracts upon transfer. The Anti-Assignment Act permits the United States to elect its response to the transfer of a contract to which it is a party. The United States may either waive its rights under the Act and continue performance, or it may terminate the contract. *See Tuftco Corp. v. United States*, 22 Ct. Cl. 277, 614 F.2d 740, 744 (Ct. Cl. 1980)(permitting the United States to waive the Anti-Assignment Act's prohibition of transfer where the government was aware of, assented in writing to, and recognized the assignment).[33]

Effect on Sales in Chapter 11 Cases

So far, we have been discussing assumption, assignment, and rejection of executory contracts. Note, however, that these rules also apply to any sale of assets in Chapter 11 cases.[34] The reason for the application is that the sale of contracts is deemed to be an assumption and assignment.

Note that there are two main types of sales in Chapter 11 cases: the pre-confirmation sale and the sale under a reorganization plan. Debtors are allowed to sell substantially all their assets under the Code: Code section 363(b) specifically allows for the sale of assets outside of the ordinary course of business, so long as the debtor obtains court approval. In determining whether a sale should be approved, courts generally apply a business judgment rule.[35] Moreover, Code section 1123(b)(4)

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[30] 440 F.3d at 441.

[31] The court noted, "Although the language of subsections ©(1) and €(2) of § 365 are similar, they are by no means parallel overall or identical in effect. The two are not sufficiently similar that caselaw interpreting the one should be given any more than informative weight in interpreting the other." 440 F.3d at 247, n.16.

[32] *Id.* at 250-251 ("the Anti-Assignment Act. . .cuts against the broad application advanced by BPA . . .both the text of the Anti-Assignment Act and the text of § 365€(2)(A) require a case-by-case inquiry into the application of the Act to the executory contract or lease at issue in the bankruptcy proceeding").

[33] *Id.* at 252. For a more detailed discussion of novation of government contracts, see Lawrence Block and Janet Nesse, *A Practical Guide to Bankruptcy & Government Contracts*, Westlaw (2013) at 158-161.

[34] See, e.g., *In re Eldercare*, 390 B.R. 762, 770, 772 (Bankr. D. Conn. 2008)(sale of assets under Code section 363(b) providing for simultaneous assumption and assignment of contracts to be transferred).

[35] *Comm. Of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.)*, 722 F.2d 1063, 1070 (2d Cir. 1983)("bankruptcy judges must not be shackled with unnecessarily rigid rules when exercising the undoubtedly broad administrative power granted . . . under the Code); *Accord Licensing by Paola, Inc. v. Sinatra (In re Gucci)*, 126 F.3d 380, 387 (2d

specifically provides that a reorganization plan may "provide for the sale of all or substantially all of the property of the estate."

Strategic Considerations

Obviously, the split in the cases on the issue of whether a debtor in possession can assume a non-assignable contract is critically important for pre-bankruptcy planning. Counsel to the debtor must be careful in choosing venue to avoid an extremely detrimental result for the estate. Under 28 U.S.C. § 1428,[36] the debtor has a wide choice of locations where it can file a case: where it is incorporated, where its principal place of business is located, or where its principal assets are located. The choice is even wider if there are a number of affiliated debtors located or incorporated throughout the country: because a company can file in the jurisdiction where an affiliate has a pending case, if even one of the debtor's affiliates is able to file a petition in a favorable jurisdiction, a company may be able to file in that jurisdiction, subject to the discretion of a court to transfer venue under 28 U.S.C. § 1412 "in the interest of justice or for the convenience of the parties."[37]

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Cir. 1997); *Myers v. Martin (In re Martin)*, 91 F.3d 389, 395 (3d Cir. 1996); *Stephen's Indus., Inc. v. McClung*, 789 F.2d 386, 389-390 (6th Cir. 1986); *Creditors of Cont'l Air Lines, Inc. v. Cont'l Air Lines, Inc. (In re Cont'l Air Lines, Inc.)*, 780 F.2d 1223, 1226 (5th Cir. 1986).

[36] 28 U.S.C. § 1408 provides as follows:

> Except as provided in section 1410 of this title, a case under title 11 may be commenced in the district court for the district –
>
> (1) in which the domicile, residence, principal place of business in the United States, or principal assets in the United States, of the person or entity that is the subject of such case have been located for the one hundred and eighty days immediately preceding such commencement, or for a longer portion of such one-hundred-and-eighty-day period than the domicile, residence, or principal place of business, in the United States, or principal assets in the United States, of such person were located in any other district; or
>
> (2) in which there is pending a case under title 11 concerning such person's affiliate, general partner, or partnership.

[37] 28 U.S.C. § 1412 provides that "A district court may transfer a case or proceeding under title 11 to a district court for another district, in the interest of justice or for the convenience of the parties."

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THE USUAL FORUMS FOR GOVERNMENT CONTRACT MATTERS

The government contractor has options in determining where claims will be litigated and the Contract Disputes Act of 1978 provides the contractor with the exclusive right to choose the forum in which to litigate any adverse decisions by a contracting officer. The contractor can select either the applicable Board of Contract Appeals or the United States Court of Federal Claims. Under the "election doctrine" the choice is binding. *See e.g. Bonneville Assoc. v. U.S.*, 43 F. 3d 649 (Fed Cir. 1994) (affirming dismissal of Court of Federal Claims action filed by the contractor after it voluntarily dismissed its Board of Contract Appeals action.). Appeals from adverse decisions in either are then taken to the United States Court of Appeals for the Federal Circuit.

The Court of Federal Claims Procedures and Locations

1. Government contractors have one year from an adverse decision by a contracting officer to file an appeal.

2. Procedures are relatively formal, similar to a non-jury trial in a United States District Court.

3. Judges may not have government contracts background.

4. Judges have more significant staff and law clerks.

5. The Court of Federal Claims has a national reach and may sit anywhere in the United States.

The Boards of Contract Appeals Procedures and Locations

1. There are three Boards of Contract Appeals—the ASBCA (Armed Services Board of Contract Appeals), which handles all DOD matters, the PSBCA (Postal Service Board of Contract Appeals), which handles matters related to the postal service, and the CBCA (Civilian Board of Contract Appeals), which handles all other matters for civilian agencies.

2. Government contractors have ninety days from an adverse decision to file an appeal of the contracting officer's decision.

3. Procedures are less formal, designed to provide redress while saving time and cost. Contractors can represent themselves *pro se*, although this is not generally a good idea if there is any significant amount at issue. The parties may agree to submit their claims without a hearing. If a claim is for $150,000 or less, even more expedited procedures may be available.

4. Judges are appointed by the agency and must have at least five years of public contract experience.

Jurisdiction of Government Contracts Forums

1. Both tribunals hear claims under the Contracts Disputes Act.

2. Only the Court of Federal Claims can hear disputes concerning the sale of real property.

3. Only the Court of Federal Claims can hear cases under the Tucker Act, which provides a waiver of sovereign immunity for certain claims against the government such as proprietary claims and certain claims of sureties.

4. In the Court of Federal Claims, the United States can bring certain fraud counterclaims, such as those arising under the False Claims Act or the fraud provisions of the Contract Disputes Act. These counterclaims could not be brought by the Government in a Board of Contract Appeals action.

5. Once a Court of Federal Claims action is brought, the contracting officer loses all authority under the contract to issue another final decision or settle the case. If a Board of Contract Appeals case is pending, the contracting officer retains authority because the case is not considered "litigation" that has been turned over to the Department of Justice pursuant to 28 U.S.C. § 516.

6. Appeal standards are slightly different. When the Court of Appeals for the Federal Circuit reviews a decision of either tribunal, the standard for reviewing decisions of law is *de novo*. When reviewing facts decided by the Court of Federal Claims, the appellate standard is whether there has been "clear error", as would be the case in any federal appeal. In reviewing factual decisions by the Boards of Contract Appeals, the court is statutorily bound to determine whether they are fraudulent, arbitrary, capricious, grossly erroneous, so as to suggest bad faith, or not supported by substantial evidence. *See* 41 U.S.C. Section 609(b). This is a much higher standard for the appellant to meet.

Advantages and Disadvantages

Each tribunal has its advantages and disadvantages. The Court of Federal Claims allows a wider range of litigation for the contractor, but also allows the Government to bring a wider range of claims against the contractor. If the issue is very complicated and may require further appellate review, the standards for reversal may be crucial. Both tribunals are bound by *stare decisis* (precedent) so a review of the cases in each is useful before a decision is made, as they are not always consistent. The particular facts or legal precedent applicable to your matter, the amount at issue, and time constraints all contribute to determination of which forum is preferable.

THE USUAL FORUMS FOR BANKRUPTCY MATTERS

Bankruptcy Court

The Bankruptcy Court is the forum in which all bankruptcy matters begin. As discussed in more detail in Chapter 3, bankruptcy cases may be filed in one of several different federal jurisdictions. The Court in the selected jurisdiction hears all routine matters related to the administration of the case, including motions to transfer the case to a different jurisdiction, motions for relief from stay, plans and disclosure statements, all of which are referred to as core matters. The Code provides a non-exclusive list of 16 items that are core. *See* 28 U.S.C. § 157 (b)(2).

There are complicated rules that relate to jurisdiction depending on whether they are core, non-core, arising under the bankruptcy case or related to the bankruptcy case. The Bankruptcy Court is an Article I court (a court of limited jurisdiction) rather than an Article III court (court of general federal jurisdiction) or a court of general jurisdiction (such as a state court). The decision of the United States Supreme Court in *Stern v. Marshall,* 131 S.Ct. 2594 (2011) made it clear that when counterclaims arise, even in the context of core matters or proofs of claims that have been filed by a creditor, they may well not fall within the jurisdiction of the Bankruptcy Court. Since *Stern v. Marshall*, the Supreme Court has held that its decision in said case did not create a "statutory gap" for claims, such as fraudulent transfers, which were required to be treated as core under 28 U.S.C. § 157, but for which the Bankruptcy Court lacked constitutional authority to enter a final judgment ("*Stern* Claims"). *See Executive Benefits Ins. Agency v. Arkison*, 134 S.Ct. 2165 (2014). The Court elaborated that while these claims were indeed listed as "core," they should also be considered within the Court's "related to" jurisdiction. The 1984 Bankruptcy Act contained a savings clause that stated if any provision of the Act was considered constitutionally invalid, no other provision would be affected. This saving clause allows Bankruptcy Courts to treat *Stern* Claims as non-core claims and to issue proposed findings of facts and conclusions of law, subject to *de novo* review by the District Court. Certain claims may be heard by the Bankruptcy Court, which will then produce findings of fact and conclusions of law to be reviewed by the United States District Court for the District so that final orders can be entered.

Appeals from the Bankruptcy Court are heard either by the United States District Court for the District or by a Bankruptcy Appellate Panel ("BAP") that has been established in certain districts. Appeals from those decisions are heard by the United States Court of Appeals for the applicable circuit.

FILING A GOVERNMENT CONTRACTS CLAIM IF THE CLAIMANT IS A DEBTOR

If a contractor files for bankruptcy, and believes that it is owed money by the Government, it may elect to file a contract claim with the appropriate Board of Contract Appeals or the Court of Federal Claims. No relief from the stay is necessary because it is an action by the debtor, not against the debtor. If the Government desired to file a counterclaim, it would need to seek relief from the automatic stay.

The forfeiture penalty is unique to litigation in federal court. In choosing to litigate in the Court of Federal Claims, rather than before a Board of Contract Appeals, a contractor risks forfeiting its entire claim should a portion of its claim be deemed fraudulent. *Daewoo Eng'g & Constr. Co. v. United States*, 73 Fed. Cl. 547 (2006), *aff'd* 557 F.3d 1332 (Fed. Cir. 2009).

If the Government files a proof of claim form with the Bankruptcy Court, the debtor could also assert that the Government had consented to the jurisdiction of the Bankruptcy Court and could file a claim in the bankruptcy proceeding, which could either be heard there or in the District Court. This would place pressure on the Government which would likely perceive the Bankruptcy Court as a forum favorable to the Debtor.

Even if the Bankruptcy or the District Court had jurisdiction over a government contract claim it might elect to abstain from jurisdiction because of the specialized nature of the claims. Pursuant to 28 U.S.C. § 1334(c)(2), the Bankruptcy Court must "abstain from hearing . . . a proceeding if an action is commenced, and can be timely adjudicated, in a state forum of appropriate jurisdiction." Where a proceeding can be resolved about as promptly as in the bankruptcy court and involves difficult issues of state law, mandatory abstention should occur. *Parmalat Capital Fin. Ltd. v. Bank of Am., Corp.*, 671 F.3d 261, 267 (2d Cir. 2012); *see also Power Plant Entm't Casino Resort Indiana, LLC v. Mangano*, 484 B.R. 290, 297 (Bankr. D. Md. 2012). In addition to mandatory abstention, 28 U.S.C. § 1334(c)(1) allows a bankruptcy court to permissibly abstain from hearing an adversary proceeding in the "interest of justice" or in the "interest of comity with state court or respect for state law." *See* 28 U.S.C. § 1334(c)(1); *see also Power Plant*, 484 B.R. at 299. Bankruptcy courts are not mandated to hear claims merely "related to" an underlying bankruptcy case when these claims fall under the statutory and case law considerations for permissive abstention. *See In re Encompass Services Corp., et al.*, 337 B.R. 864, 877 (Bankr. S.D. Tex. 2006).

Choices must be made after evaluation of the merits of the claim, the nature of the claim, the expenses of litigation and other similar determinations.

GOVERNMENT CONTRACT PERSPECTIVE

Contract Terminations for Convenience & Default—A Summary Review

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Contractors can be terminated by the government for convenience—through no fault of their own, or by default—as the result of a failure to comply with contractual terms or requirements. Each type of termination carries with it distinct obligations, risks, responsibilities, recoveries and potential remedies. Below is a brief overview of some of the key aspects and differences between government terminations for convenience and for default.

I. Contract Terminations for Convenience

A termination for convenience ("T4C") gives the federal government a unilateral contractual right to partially or completely terminate a contract when it is in the best interests of the government, usually when the government's requirements or needs are reduced or eliminated. This right does not exist in private commercial contracting and is unique to the federal government because of its duty to efficiently spend taxpayer dollars.

A T4C allows an agency to terminate a contract without being required to pay damages or expected contract profit for work that has not yet been completed. A T4C termination also allows the government to terminate a contract without any contractor fault, and therefore a contractor's compliance with the contract terms has no bearing on the government's ability to exercise its T4C right. For a contractor, it is preferable to receive a T4C as opposed to a default termination, because a T4C casts no reflection on the quality of the contractor or work performed. Importantly, because a T4C does not reflect on the contractor's performance, it cannot be held against a contractor when it seeks future contracts.

One of the few limitations on the government is that it cannot terminate for convenience simply to obtain a better price from another contractor. *See Krygoski Construction Co. v. United States*, 94 F.3d 1537, 1541 (Fed. Cir. 1996) ("A contracting officer may not terminate for convenience in bad faith, for example, simply to acquire a better bargain from another source. When tainted by termination for convenience bad faith or an abuse of contracting discretion, a termination for convenience causes a contract breach"). Accordingly, a contractor that has been terminated for convenience should seek evidence that the terminating agency was negotiating with another contractor for the same scope of work (*e.g.*, 8(a) sole source awards), or evidence that the government has prepared a solicitation for the same scope of work as that under the contract terminated for convenience. An unlawful or bad-faith termination for convenience by the government constitutes a breach of contract, but carries a high burden of proof by the contractor to demonstrate the government's bad-faith or improper motive. *See Gulf Group Gen. Enters. Co. W.L.L. v. U.S.*, 2013 U.S. Claims Lexis 899 (July 2, 2013).

The government's right to terminate for convenience is expressed in a mandatory contract clause, though the clause need not be included in a contract in order for the government to be able to exercise its T4C right. *See Rockies Express Pipeline LLC v. Salazar*, 2013 U.S. app. Lexis 18967 (Fed Cir. Sept. 13, 2013). Accordingly, a contractor should be sure to include a T4C clause in all of its subcontracts and purchase orders, otherwise the contractor risks breach of contract actions by a terminated subcontractor, even if the cause of the downstream termination is the government's T4C.

T4C's allow a contractor to recover certain prescribed damages, including the percentage of the contract price reflecting the work performed prior to the notice of the termination, and any

charges the contractor can demonstrate directly resulted from the termination.[1] Generally, this means the government should compensate the contractor for its reasonable, allowable and allocable costs up to the date of termination, plus reasonable termination costs, as well as a reasonable profit on the work that has been performed already.

A T4C that results only in a partial contract termination requires the contractor to continue to perform the non-terminated portion of the contract, and may give rise to the need for the contractor to file a request for equitable adjustment ("REA") with the contracting officer ("CO") for the continuing portion of the contract because the contractor's costs may have increased based on the government's partial termination. *See* FAR 52.249-2.

A T4C is most often initiated by the CO through issuance of a notice of termination in accordance with FAR Part 49.102. *See* FAR 52.249.2.[2] The notice must contain the pertinent FAR clause on termination, the effective date of the termination, the extent of the termination,

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[1] Depending on the type of procurement, a contractor's rights upon a T4C can differ significantly. For example, the termination provisions under Federal Acquisition Regulation ("FAR") Part 49 apply cost principles, whereas the termination provisions under FAR Part 12 concerning commercial items contracts do not. Under a T4C issued against a contract awarded under FAR Part 49, the contractor is entitled to the reasonable costs of terminating the work and settlement expenses, plus a reasonable profit. Under a T4C issued against a commercial item (FAR Part 12) contract, however, the contractor is not bound by cost principles, is not subject to audit (as with a FAR Part 49 termination), and generally can recover the percentage of the contract price reflecting the percentage of the work performed prior to the notice of the termination, as well as any charges the contractor can demonstrate directly resulted from the termination.

[2] In circumstances where the government does not issue a notice of termination, but does not allow the contractor to perform work under the contract for one reason or another, the contractor may be able to argue that the government constructively terminated the contract. *See, e.g., Zip-O-Log Mills Inc. v. U.S.*, U.S. Claims Lexis 1455 (Sept. 30, 2013).

any special instructions, and the steps the contractor should take to minimize the impact on personnel if the termination will result in a significant reduction in the contractor's work force. [3]

After receipt of a T4C termination notice, the contractor should comply with the notice and applicable contract clauses. In general, the contractor must stop work immediately on the terminated portion of the contract, and stop placing orders to subcontractors under the contract. The contractor should also terminate all subcontracts related to the terminated portion of the contract, and commence efforts to settle subcontractor claims resulting from the T4C.[4] The contractor usually is instructed to perform the continued portion of the contract and to promptly submit any REA for the rest of the continued portion if the termination effects changes to the contractor's cost of continued performance.

The terminated contractor is also required to care, preserve, and dispose of government property and promptly submit its settlement proposal with schedules and proposed actions to be taken concerning termination inventory. A written settlement proposal must be submitted to the government within one year of the date of termination. The contractor should retain sufficient documentation to demonstrate the extent of its costs resulting from the T4C along with all of its communications with the government.

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[3] If a T4C can be accomplished without cost, FAR Part 49.101 states that the CO should precede with a no-cost settlement rather than a termination notice when: (1) it is known that the contractor will accept such settlement, (2) government property was not furnished, and (3) there are no outstanding payments, debts due the government, or other contractor obligations.

[4] Under FAR 49.108-1, the subcontractor has no contractual rights against the government when the prime contractor is terminated. In fact, the CO may grant authorization for subcontract settlements without approval or ratification when the following conditions exist: (1) the amount of the settlement is $100,000 or less, and (2) the CO is satisfied with the procedures used by the contractor, especially as related to termination inventory.

If a contractor is declared bankrupt, the government has the right to seek a T4C, but it must first seek relief from the bankruptcy court from the automatic stay that is effective upon the contractor's bankruptcy filing.

II. Contract Terminations for Default

A termination for default ("T4D") is the most severe form of termination resulting from contractor non-compliance or performance issues. Under the standard FAR default clause (e.g., FAR 52.249-8), a T4D occurs when the contractor:

- fails to deliver supplies or perform services within the time specified in the contract;
- fails to satisfactorily perform any other term or condition of the contract; or
- fails to make adequate progress and thus endangers performance of the contract.

The default clause appears to give the government the ability to terminate whenever it determines that a contractor has not strictly complied with the terms of its contract. However, a T4D is in essence a breach of contract claim by the government, thus the government bears the burden of proof if the T4D is challenged by the contractor.

The Civilian Board of Contract Appeals decided that a termination for cause (similar to a termination for default but issued against a contract for commercial items) is "a drastic sanction which should be imposed (or sustained) only for good grounds and on solid evidence." *See C-Shore International, Inc. v. Department of Agriculture*, CBCA 1697, 10-1 BCA ¶ 34,380, at 169,745 (citing *Lisbon Contractors, Inc. v. United States*, 828 F.2d 759, 765 (Fed. Cir. 1987) (quoting *J.D. Hedin Construction Co. v. United States*, 408 F.2d 424, 431 (Ct. Cl. 1969))).

The cost consequences resulting from a T4D can be devastating, and may include loss of the ability to make a profit, immediate loss of work, potential loss of key employees to competitors,

the requirement to return unliquidated progress payments to the government, liability to the government for potential excess costs of re-procurement, and the costs of hiring legal counsel to defend against the T4D. A T4D will also have a negative past performance impact when a contractor is evaluated for future contracts (*e.g.*, *Advanced Computer Concepts*, B-408084, 2013 CPD ¶126) and, depending on the grounds of default, may constitute grounds for suspension or debarment of the contractor from future federal contracting.

The CO has discretion to decide which type of terminating action to take and typically considers the following factors when going considering issuing a T4D:

- the terms of the contract and applicable laws and regulations;
- the specific failure of the contractor and the excuses for the failure;
- the availability and urgency of the supplies or services from other sources;
- the degree of importance of the contractor in the government acquisition program and the effect of a termination for default upon the contractor's capability as a supplier under other contracts;
- the effect of a termination for default on the ability of the contractor to liquidate guaranteed loans, progress payments, or advance payments; and
- any other pertinent facts and circumstances.

See FAR 409.402. The government will provide written warning before issuing a T4D, typically by means of a cure notice or show cause notice similar to those found in FAR 49.607. A cure notice informs the contractor that contractual obligations have not been supplied, or that performance progress on the contract has not been adequate and may endanger meeting contractual obligations. A cure notice customarily provides 10 days, or longer as necessary, for the contractor to supply the necessary documents to demonstrate its ability to perform or actually fulfill the contract's requirements. A show cause notice advises the contractor that a T4D is being considered and informs the contractor about the related liabilities.

A contractor that believes it was not at fault and should not have been terminated for default may bring a claim against the government under the Contract Disputes Act in the U.S. Court of Federal Claims, or before the appropriate Board of Contract Appeals, but bears the burden of showing the alleged default did not exist or was excusable. *See In re A-Greater New Jersey Movers, Inc.*, ASBCA 54745 2006-1 BCA ¶33179; *ADT Construction Group, Inc.*, ASBCA 55358 2013-1 BCA ¶35,307. If the court or board finds the T4D was improper or excusable, it generally will be converted into a T4C. *See, e.g.*, FAR 52.249-8(g).

The automatic stay provision applicable upon a contractor's bankruptcy filing generally prohibits the government from exercising its administrative and contractual rights under the FAR to take any action against the contractor/debtor's estate property, whether it is inventory, funds, supplies, or the contract itself. Additionally, if a contractor is in bankruptcy, the government is prohibited from terminating a contract with the contractor for default unless the government obtains permission from the bankruptcy court. In many cases, even pre-petition T4Ds will be subject to the automatic stay. *See, e.g., In re Corporacion de Servicios Medicos Hospitalarios de Fajardo*, 805 F.2d 440 (1st Cir. 1986). Typically, a hearing in the bankruptcy proceeding will be required to determine whether a default has occurred and the government's desired T4D action is thus appropriate.

Generally, the continued existence of the contract upon a contractor's bankruptcy filing depends upon factors such as which bankruptcy chapter the contractor/debtor petitions under; the bankruptcy trustee's decision as to whether the contract is needed to support a reorganization; whether the contract is considered an executory contract under 11 U.S.C. §365; and other limitations on the ability of the trustee to assume the contract. If the contractor has not completed performance and the government has not paid the full contract price, the contract is

considered executory and generally can be assumed as part of the contractor/debtor's estate. If the contract is no longer executory, however, the trustee, not the government, decides pursuant to section 365 of the Bankruptcy Code whether the contract is rejected or assumed. Should the trustee reject the government contract, a breach occurs and a damages claim is allowed as if the government had terminated the contract for default before the bankruptcy petition filing. In contrast, if the contract is no longer executory due to a completion of performance (*e.g.*, payment by the government), Section 365 no longer applies, the trustee may not assume the contractor/debtor's uncompleted portion of the contract, and the government is left to file a claim for breach.

If the contract was in default at the time of the bankruptcy petition, the trustee must promptly cure the default and provide appropriate guarantees of future performance before assuming the contract. In practical terms, this restriction reduces the ability of the trustee to force the government to continue the contract with an unreliable contractor.

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False Claims Act Considerations in Bankruptcy Matters

October 6, 2014

Hilary Cairnie, Esq.

The False Claims Act Overview

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- FCA liability generally arises with the knowing submission to the Government of a false or fraudulent claim.
- Civil action can be initiated the Department of Justice (DOJ); Recent years have seen a noticeable increase in the number of DOJ-initiated actions.
- FCA actions can also be brought by *qui tam* relators. The Government has the option to intervene and join the relator in the suit.

2

Triggering Conduct

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- An FCA violation occurs when a person:
  - Knowingly makes, uses, or causes to be made
  - A false record or statement that is
  - Material to a false or fraudulent claim.
- Key Points: Implied Certification, Materiality, and Intent

3

FCA Implied Certification

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- When a contractor has a legal or contractual obligation to fulfill certain conditions when performing a Government contract, the contractor "impliedly certifies" its compliance with those conditions by the mere act of submitting a claim for payment for goods or services provided under the contract.

4

FCA Intent

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- A knowing false submission occurs when there is
  - actual knowledge of the information;
  - acts in deliberate ignorance of the truth or falsity of the information; or
  - acts in reckless disregard of the truth or falsity of the information.
- Negligence is *not* actionable.

5

Materiality

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The false record or statement must be ***material***

- "having a natural tendency to influence, or be capable of influencing, the payment or receipt of money or property."
- Can be through express contractual language specifically linking compliance to eligibility for payment **or** that both parties to the contract understood that payment was conditional on compliance with the requirement at issue.

6

FCA Actions and Bankruptcy (Government Actions)

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- The Bankruptcy Code's automatic stay stops most litigation or collection efforts.
- An exception is the invocation of the "police powers" exception, which can be invoked in the context of FCA litigation
  - The police powers exception applies to the commencement or continuation of certain types of litigation "by a Governmental unit . . . to enforce such Governmental unit's or organization's police and regulatory power, including the enforcement of a judgment other than a money judgment, obtained in an action or proceeding by the Governmental unit to enforce such Governmental unit's or organization's police or regulatory power."
  - The police powers exception exists in order to prevent debtors from using the bankruptcy courts to frustrate necessary governmental functions.
- Typically the police powers exception is invoked by the Government.

7

FCA Actions and Bankruptcy (Relator Actions)

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- Private parties bringing FCA *qui tam* actions have argued that they should also be allowed the benefit of the police powers exception to the automatic stay.
- Whether the police power exception is extended to qui tam relators is largely based on whether the Government intervenes in the action.
  - In cases where the Government intervenes, the court is likely to find that the action is subject to the police powers exception to the automatic stay.
  - In cases where the Government has decided not to intervene, courts generally hold that the action is not entitled to the police powers exception.

8

Questions?

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Not So Fast -- Government Contracts and Payments Are NOT Freely Assignable

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[1] The author would like to thank Mark Thom, a summer associate at Womble Carlyle Sandridge & Rice LLP, for his significant contribution to this paper.

Introduction

Federal government contracts do not contain consent to assignment clauses found in commercial contracts; instead laws and regulations govern the transfer of contracts and their receivables to third parties. This article explains the Anti-Assignment Acts and the impact they have on government contracts in a bankruptcy context. Practical approaches to accomplish what is permitted freely in a commercial setting are discussed.

I. The Assignment of Claims Act of 1940 (or the "Anti-Assignment Act")

The Assignment of Claims Act of 1940 is often referred to as the "Anti-Assignment Act." For practical purposes, however, the Anti-Assignment Act consists of two statutes that govern two different scenarios: (1) the Assignment of Contracts Act (the "Contracts Act")[2]; and (2) the Assignment of Claims Act (the "Claims Act")[3] (collectively, the "Anti-Assignment Acts"). The Tucker Act gives the United States Court of Federal Claims jurisdiction to award damages for any claim founded upon any express or implied contract with the United States, thus waiving the United States government's sovereign immunity.[4] The Anti-Assignment Acts, however, withdraw the Tucker Act's waiver of sovereign immunity,[5] rendering claims relying upon any assignment ineffective against the United States unless that assignment complies with the Acts' requirements or the government waives the protection of the Acts. Together, the Acts prevent the free assignment of: (i) a claim against the government; (ii) a government contract; or (iii) some lesser or future interest in a government contract.

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[2] 41 U.S.C. § 15 (note that Title 41 deals with government procurement).

[3] 31 U.S.C. § 3727 (note that Title 31 deals with government finance).

[4] 28 U.S.C. § 1491(a)(1).

[5] *Ins. Co. of the W. v. United States*, 243 F.3d 1367, 1375 (Fed. Cir. 2001).

The rationale for the government's strict control is based in its overall procurement process. The government is required to conduct full and open competition for most contracts with certain exceptions.[6] Each contractor that is awarded a contract is reviewed to ensure it is responsible financially, operationally, in terms of its integrity and in other ways.[7] To allow contracts to be freely assigned after going through the expense and time to conduct these procurements would render them ineffective and irrelevant.

II. Bankruptcy and the Contracts Act

When filing for bankruptcy, a debtor-in-possession ("DIP") or a trustee can find powerful support in the statutory right to reject, assume or "assume and assign" executory contracts.[8] Executory contracts[9] fall under the broad umbrella of "property of the bankruptcy estate" as defined in Section 541 of the Bankruptcy Code.[10] Both a benefit and a burden for debtors, "property of the bankruptcy estate" is protected by an automatic stay following a bankruptcy petition but is also subject to the claims of creditors. If valuable, these executory contracts are assets. They can either be assumed and performed by the DIP/trustee or else assigned to a third party for cash and other consideration, thereby bringing value to the estate and providing continuous performance under the contract to the non-debtor. Notwithstanding, if the debtor is a government contractor who intends to sell assets out of bankruptcy, a transfer will be prohibited unless the government provides its clear consent. To effect the government's consent, a novation

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[6] 10 U.S.C. § 2304; 41 U.S.C. § 3301; FAR Part 6.

[7] FAR 9.104-1.

[8] 11 U.S.C. § 365(a).

[9] *See N.L.R.B. v. Bildisco & Bildisco*, 465 U.S. 513 (1984) (defining an executory contract to be a contract in which "performance is due to some extent on both sides").

[10] *See* 11 U.S.C. § 541.

agreement—which will be subject to stringent regulations and often lengthy timelines—is usually required.

A. Rejecting Contracts in Bankruptcy

Procedures can vary depending on whether a DIP/trustee desires to reject, assume, or assume and assign its government contract during bankruptcy. If a contract is rejected, then the procedure is generally straightforward. Like the rejection of a commercial contract, the rejection of a government contract is not considered a dissolution or termination, but rather a "court-authorized breach by the debtor."[11] Accordingly, the government could elect to file a claim against the bankruptcy estate for relevant damages arising out of the breach, typically using the default termination clause in the contract.

B. Assumption and Assignment: When is the Contracts Act Implicated?

Under normal circumstances, courts often hold in favor of a party's freedom to assign its executory contracts, unless specific contractual anti-assignment provisions provide otherwise. Government contracts, however, add a layer of complexity to this standard preference. Unlike a contract rejection, a contract assumption or assignment requires government consent and is scrutinized by the bankruptcy court.

1. What is "applicable law" under § 365(c)?

Section 365(c) of the Bankruptcy Code states the trustee may not "assume or assign" any executory contract where "applicable law excuses a party to such contract or lease from accepting performance" by any "entity other than the debtor or debtor in possession."[12] In every case, "applicable law" has been interpreted to mean "applicable non-bankruptcy law."

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[11] Lawrence Block & Janet Nesse, A PRACTICAL GUIDE TO BANKRUPTCY & GOVERNMENT CONTRACTS, Thomas Reuters/Westlaw 2013, at 157.

[12] 11 U.S.C. § 365(c)(1)(A).

2. The Contracts Act as "applicable law"

In almost every case, the Contracts Act has been interpreted to be an "applicable non-bankruptcy law." Pursuant to the Contracts Act, the party to whom the government contract is awarded is prohibited from transferring the contract to any other party.[13] Therefore, in contrast to the standard preference to encourage free assignment, the Contracts Act effectively prohibits the transfer of government contracts from a contractor (in bankruptcy proceedings, the DIP/trustee) to a third party.[14]

C. Assuming Contracts in Bankruptcy

As of the date of this article, the majority of courts interpret the Contracts Act to prohibit both the assumption and the assignment of contracts over the objection of the government. Nevertheless, depending on the jurisdiction, the DIP/trustee may be permitted to assume the contract, but not assign it, even in the face of a government objection. The jurisdictional split arises out of two interpretations of the phrase "assume or assign" under § 365(c).

1. Two Tests for Assuming a Contract

In Chapter 11 proceedings, where the entity at issue reorganizes its debt but continues operating, bankruptcy courts have applied two distinct tests for deciding whether a DIP/trustee may assume a contract: (1) the "hypothetical test" and (2) the "actual test."

2. The "Hypothetical Test"

Jurisdictions that apply the "hypothetical test" interpret the language "assume or assign" under § 365(c) according to its plain meaning rather than reading "or" to also mean "and." Because the government is in a position to make such a hypothetical refusal under the Contracts

[13] 41 USC § 15.

[14] Block & Nesse, *supra*.

Act's assignment prohibition, the DIP/trustee cannot assume its pre-petition contract. The federal courts in the Third, Fourth, Ninth, and Eleventh Circuits use the "hypothetical test."[15]

3. The "Actual Test"

In contrast, jurisdictions that apply the more liberal "actual test" strive to maneuver around the Code's rigid language. These jurisdictions argue that the purpose of § 365(c) is to ensure that the creditor-counterparty gets what it bargained for—that is, the services of the debtor. Under the "actual test" standard, only actual assignment should be barred. Thus, where the DIP/trustee seeks to assume an executory contract but refrains from assigning it to a third party, an "actual test" court will permit the assumption. The federal courts in the First, Fifth, and Seventh Circuits and a majority of the undecided circuits' bankruptcy and district courts utilize the "actual test."[16]

4. Breach after Assumption

If a DIP/trustee elects to assume a contract and perform under its terms, and subsequently breaches, then the non-debtor can enforce its rights as if there were no bankruptcy proceedings. In that case, the government (as the non-debtor party) can attach other assets that may otherwise be protected by the automatic stay triggered by a bankruptcy filing to satisfy its termination for default damages.

D. Assigning Contracts in Bankruptcy

Unlike the ambiguity that arises when a DPI/trustee chooses to assume a government contract, government consent will be required when a DIP/trustee desires to assign its

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[15] *See, e.g., In re Catapult Entm't Inc.*, 165 F.3d 747 (9th Cir. 1999); *In re Sunterra Corp.*, 361 F.3d 257 (4th Cir. 2004).

[16] *See, e.g., Institut Pasteur v. Cambridge Biotech Corp.*, 104 F.3d 489 (1st Cir. 1997); *Bonneville Power Admin. v. Mirant Corp.* (In re Mirant Corp.), 440 F.3d 238 (5th Cir. 2006).

government contract to a third party. Pursuant to the Federal Acquisition Regulation ("FAR"), which is held to have the force and effect of law, the government is not required to concur in the transfer of a contract from one company to another if it is not in its interest to do so.[17] In such cases, the contractor will be prohibited from assigning its government contract, whether through a Chapter 11 reorganization plan or through a § 363 sale.

1. Novations to Effect Assignment

If the government consents to an assignment, then its consent will usually be effected by a formal novation agreement. Under FAR Subpart 42.12, a novation agreement will generally be required when the third party's interest in the contract arises out of the transfer of: (1) all the contractor's assets; or (2) the entire portion of the assets involved in performing the contract.[18] Such is generally the case in the sale of a Chapter 11 debtor's assets through a reorganization plan or through a § 363 sale. The contractor (the transferor), the transferee, and the government Contracting Officer ("CO") will be required to agree to a tri-party novation that will require various specific provisions[19] and will be contingent upon approval of the three parties as well as the bankruptcy court.

2. Novation Requirements and Factors Considered

FAR Subpart 42.12 sets forth a variety of documents that must be submitted to the responsible "CO". The CO responsible for processing the novation is permitted discretion in reaching his or her decision to execute the novation agreement. In essence, the CO's inquiry will focus on whether it is in the government's best interest to approve the transfer.[20] Specifically, the

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[17] FAR 42.1204(d); *American General Leasing Inc. v. United States*, 587 F.2d 54, 58 (Fed. Cir. 1978) ("The Federal Procurement Regulations have the force of law.")

[18] *See* FAR 42.1204(a).

[19] *See* FAR 42.1204(e).

[20] *See* FAR 42.1203.

CO will review the comments received from the affected contracting offices, the proposed successor's responsibility under FAR Subpart 9.1, and any factor relating to the proposed successor's performance that the government determines would impair the proposed successor's ability to perform the contract satisfactorily.

Under normal circumstances, the FAR requires the contractor (i.e., the transferor) to act as a surety in guaranteeing payment of all liabilities and performance of all obligations that the successor-in-interest (i.e., the transferee) assumes under the novation.[21] In the bankruptcy context, however, any continued liability of the original debtor is likely to be suboptimal (at best) or worthless (at worst). Therefore, the government will conduct adequate due diligence, with the understanding being that it may be forced to rely solely upon the successor-in-interest's financial health for outstanding liabilities.

3. Learn Tactics from the *Tactical* Case

The procedural timeline for effecting a novation agreement can be plodding. The CO is under no statutory or regulatory deadlines, and practitioners should be aware of the potential administrative obstacles. To prevent further delays where government contracts are concerned, bankruptcy practitioners can learn from a recent bankruptcy case.

On August 18, 2014, the Department of Defense ("DoD") took issue with bankrupt outfitter Tactical Intermediate Holdings Inc.'s planned $13 million stalking horse sale of its military apparel line, saying the possible inclusion of the debtor's U.S. Army contract violates federal regulations. Tactical planned to unload its Massif Holdings LLC unit through a Section 363 auction, but DoD contended that the sale motion ignores the government's right to reject the transfer of government contracts, according to a limited objection filed in Delaware bankruptcy

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[21] *See* FAR 42.1204(b)(8).

court. The government "objects to the sale motion to the extent that it proposes to authorize the sale, assumption and assignment of executory DoD contracts in violation of federal law and regulations."[22]

On August 22, 2014, a Delaware bankruptcy judge approved Tactical Intermediate Holdings, Inc.'s, sale of its apparel division to Samtech LLC, whose bid beat out the stalking horse offer.[23] To satisfy the DoD, Tactical added DoD's proposed language to the sale order; making it clear that the government has the right under the Contracts Act to reject the assignment of federal contracts should it choose to do so. The relevant language in the sale order reads as follows:

> This Sale Order, the Asset Purchase Agreement, and the Transaction Documents shall not authorize the Purchaser, the Debtors, and/or their affiliates, successors and/or assigns, to take any action with respect to any Government Contracts or other Assets inconsistent with the Anti-Assignment Act, 31 U.S.C. § 3727, or the Federal Acquisition Regulation, Code of Federal Regulations Title 48. Nothing in this Sale Order, the Asset Purchase Agreement, or the Transaction Documents shall be interpreted to require the federal government to novate or otherwise consent to the transfer of any intellectual property, licenses, inventions, authorizations, leases, contracts, agreements, or other interests of the federal government; and nothing shall be interpreted to set cure amounts. The federal government's right to offset or recoup any amounts due under, or relating to, any intellectual property, licenses, inventions, authorizations, leases, contracts, agreements, or other interests of the federal government are expressly preserved.[24]

To effect the transfer of the Army contract, Tactical, Samtech, and the Army CO must now enter into a novation agreement.

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[22] *See* Jamie Santo, *DOD Knocks Tactical's Planned $13M Bankruptcy Sale*, LAW 360, (August 18, 2014, 9:31 PM ET), available with subscription at http://www.law360.com/governmentcontracts/articles/568556?nl_pk=957f12e5-420c-48b0-ab05-f16f53fd7d86&utm_source=newsletter&utm_medium=email&utm_campaign=governmentcontracts.

[23] *See*, Matt Chiappardi, Tactical Gets OK For Up To $15M Sale Of Military Apparel Line, LAW 360, (August 22, 2014, 6:43 PM ET), http://www.law360.com/governmentcontracts/articles/570071?nl_pk=957f12e5-420c-48b0-ab05-f16f53fd7d86&utm_source=newsletter&utm_medium=email&utm_campaign=governmentcontracts.

[24] In re Tactical Intermediate Holdings, Inc., *et al.*, Case No. 14-11659 (KG) (2014), ¶ 43.

III. Bankruptcy and the Claims Act

While the Contracts Act focuses on the assignment prohibition for contracts, the Claims Act focuses on claims for payment under government contracts. Understanding the requirements for claim assignments can be crucial in situations involving financing or third party lenders. The Claims Act prohibits the assignment of a claim against the government, unless (i) the claim has already been allowed; (ii) the amount of the claim has been decided; and (iii) a warrant for payment of the claim has been issued.[25]

In a commercial setting as between businesses, the procedures for assignment of claims are established by the Uniform Commercial Code ("UCC"). Upon being presented with notice that accounts receivable have been sold and/or assigned to a third party, a business buyer of goods or services simply forwards future payments to that third party. In the government contract setting as between businesses and the government, however, the claims assignment process requires more than mere notice.

A. Requirements for Claims Act Assignment

The Claims Act and the corresponding FAR guidance require four original copies of a specifically worded assignment agreement, a notarized authorization and corporate seal from the transferor, and the written execution and return of a Notice of Assignment form by the government.[26] Any claim assignments that do not adhere to these requirements run the risk of being deemed invalid by the courts.

B. Perfecting Security Interests with a UCC-1

Importantly, claims assignment through the Claims Act does not perfect a lender's security interest in government contract receivables. Like commercial scenarios as between

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[25] 31 U.S.C. § 3727

[26] *See generally* FAR 32.8.

businesses, perfection of a lender's security interest will require the filing of UCC-1 financing statement among relevant state records.

IV. Government Identifiers and Bank Accounts

The government has consolidated government contractor identifiers (DUNS number, CAGE code) bank account numbers and more in the website www.sam.gov.[27] Before award of a government contract or grant, the offeror must be registered on sam.gov, with few exceptions. Any change in the information due to corporate restructuring, assignment of receivables or the contract, or change in bank accounts will trigger a red flag to cease payments until either the sam.gov registration is corrected or the contract is modified or novated to reflect the correct contractor. The FAR explains this to contracting officers:

> (c)(1)(i) If a contractor has legally changed its business name, "doing business as" name, or division name (whichever is shown on the contract), or has transferred the assets used in performing the contract, but has not completed the necessary requirements regarding novation and change-of-name agreements in Subpart 42.12, the contractor shall provide the responsible contracting officer a minimum of one business day's written notification of its intention to change the name in the SAM database; comply with the requirements of Subpart 42.12; and agree in writing to the timeline and procedures specified by the responsible contracting officer. The contractor must provide with the notification sufficient documentation to support the legally changed name.
>
> (ii) If the contractor fails to comply with the requirements of paragraph (c)(1)(i) of the clause at 52.204-13, System for Award Management Maintenance, or fails to perform the agreement at 52.204-13, paragraph (c)(1)(i)(C), and, in the absence of a properly executed novation or change-of-name agreement, the SAM information that shows the contractor to be other than the contractor indicated in the contract will be considered to be incorrect information within the meaning of the "Suspension of Payment" paragraph of the EFT clause of the contract.
>
> (2) The contractor shall not change the name or address for electronic funds transfer payments (EFT) or manual payments, as appropriate, in the SAM record to reflect an assignee for the purpose of assignment of claims (see Subpart 32.8, Assignment of Claims).

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[27] FAR 4.1102.

> (3) Assignees shall be separately registered in the SAM database. Information provided to the contractor's SAM record that indicates payments, including those made by EFT, to an ultimate recipient other than that contractor will be considered to be incorrect information within the meaning of the "Suspension of payment" paragraph of the EFT clause of the contract.[28]

To ensure continued payment in the course of bankruptcy proceedings, attention to the information contained in sam.gov and communication with the relevant CO is important.

V. Waiving the Anti-Assignment Acts

Although obtaining government consent through a novation agreement is the preferred way that a DIP/trustee can perfect rights to contracts and claims, case law from the United States Court of Federal Claims has clearly established that the government may also waive its rights under the Acts so long as it clearly states its intention to do so.[29] Going further, in *Ins. Co. of the West v. United States*, the Court of Federal Claims acknowledged that "even if the government does not expressly waive the Anti-Assignment Acts, implied waiver can still be found based on the government's conduct."[30]

Similarly, in *Tuftco Corp. v. United States*,[31] the court discussed waiver of application of the Acts by a government CO, holding that the government had in fact waived its rights. In that case, an insurance company was awarded two contracts by the government to provide mobile homes. The insurance company assigned the contracts to another contractor to build and deliver the mobile homes. After the assignments were executed, the contractor informed the CO of the arrangement. The government made no objection to the change and made only one payment to the contractor for its work. Upon the insurance company's default, the contractor sued the

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[28] FAR 4.1102(c).

[29] *Ins. Co. of the West v. United States*, 100 Fed. Cl. 58, 66 (Cl. Ct. 2011).

[30] *Id.*

[31] *Tufto Corp. v. United States*, 222 Ct. Cl. 277, 287-88 (1980)

government, reasoning that the totality of the circumstances evidenced that the government had waived any prohibition it may have had on assignments. There, the court agreed with the contractor, highlighting that the CO knew of the assignment, assented to it by its payment to the contractor, and recognized it through correspondence.

Although the court has gone along with the government's informal waiver of its rights under the Acts (such as rendering payments through an authorized CO) in some cases, most likely to ensure equity in the situation, we recommend that the formalities of novation and assignment agreements be observed.

Conclusion and Tips

- Despite the lack of a consent to assignment clause, government contracts and their receivables are not freely assignable
- Consult with the CO for the contract to see if a novation, change-of-name, or other formal indication of consent to transfer can be achieved
- Review the sam.gov database and take appropriate action before changing the payee's name, address, bank account, or other information

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Contractor Rights/Responsibilities[1]

The Contractor has the responsibility to notify the Government agencies with whom the Contractor has open contracts of a bankruptcy filing. Every federal contract has the following clause inserted:

52.242-13 Bankruptcy.
As prescribed in 42.903, insert the following clause:

BANKRUPTCY (JULY 1995)

> In the event the contractor enters into proceedings relating to bankruptcy, whether voluntary or involuntary, the contractor agrees to furnish, by certified mail or electronic commerce method authorized by the contract, written notification of the bankruptcy to the contracting officer responsible for administering the contract. This notification shall be furnished within five days of the initiation of the proceedings relating to bankruptcy filing. This notification shall include the date on which the bankruptcy petition was filed, the identity of the court in which the bankruptcy petition was filed, and a listing of government contract numbers and contracting offices for all government contracts against which final payment has not been made. This obligation remains in effect until final payment under this contract.

There is no ambiguity. Contractors must notify within 5 days of the filing. Failure to comply may result in a claim for damages by the Government.

In addition to the notification requirement, contractors have a responsibility to ensure that GFE/GFP furnished to the contractor is maintained and preserved for the Government. This includes GFE/GFP in the possession of subcontractors. The contractor is directly responsible and accountable for all Government property in accordance with the requirements of the contract.

The Contractor has a responsibility to mitigate loss to the government so as not to trigger unliquidated damages.

[1] Excerpt from Lawrence Block & Janet Nesse, A Practical Guide to Bankruptcy & Government Contracts (2013).

Novation

Novation is the Government's express consent to a substitution of contractors. If possible, most contractors would prefer to avoid a novation as it involves many administrative hurdles and includes no time limits, so the Government can drag its feet if it wishes. An informal arrangement with a C.O. is just as effective but not as time-consuming.

In the bankruptcy context, the Government wants to conduct sufficient due diligence that the transferee of the novated contract will have the economic means to perform the contract. While this is a general requirement under the FAR, Government officials realize that any continued liability on behalf of the debtor is probably worthless so the Government has to rely solely upon the financial condition of the new contractor.

The Government may, when in its interest, recognize a third party as the successor in interest to a Government contract when the third party's interest in the contract arises out of the transfer of --

(1) All the contractor's assets; or

(2) The entire portion of the assets involved in performing the contract. (See 14.404-2(l) for the effect of novation agreements after bid opening but before award.) Examples of such transactions include, but are not limited to --

(i) Sale of these assets with a provision for assuming liabilities;

(ii) Transfer of these assets incident to a merger or corporate consolidation; and

(iii) Incorporation of a proprietorship or partnership, or formation of a partnership.

(b) A novation agreement is unnecessary when there is a change in the ownership of a contractor as a result of a stock purchase, with no legal change in the contracting party, and when that contracting party remains in control of the assets and is the party performing the contract. However, whether there is a purchase of assets or a stock purchase, there may be issues related to the change in ownership that appropriately should be addressed in a formal agreement between the contractor and the Government (see 42.1203(e)).

(c) When it is in the Government's interest not to concur in the transfer of a contract from one company to another company, the original contractor remains under contractual obligation to the Government, and the contract may be terminated for reasons of default, should the original contractor not perform.

(d) When considering whether to recognize a third party as a successor in interest to Government contracts, the responsible contracting officer shall identify and evaluate any significant organizational conflicts of interest in accordance with subpart 9.5. If the responsible contracting officer determines that a conflict of interest cannot be resolved, but that it is in the best interest of

the Government to approve the novation request, a request for a waiver may be submitted in accordance with the procedures at 9.503.

(e) When a contractor asks the Government to recognize a successor in interest, the contractor shall submit to the responsible contracting officer three signed copies of the proposed novation agreement and one copy each, as applicable, of the following:

(1) The document describing the proposed transaction, e.g., purchase/sale agreement or memorandum of understanding.

(2) A list of all affected contracts between the transferor and the Government, as of the date of sale or transfer of assets, showing for each, as of that date, the --

(i) Contract number and type;
(ii) Name and address of the contracting office;
(iii) Total dollar value, as amended; and
(iv) Approximate remaining unpaid balance.

(3) Evidence of the transferee's capability to perform.

(4) Any other relevant information requested by the responsible contracting officer.

(f) Except as provided in paragraph (g) of this section, the contractor shall submit to the responsible contracting officer one copy of each of the following documents, as applicable, as the documents become available:

(1) An authenticated copy of the instrument effecting the transfer of assets; e.g., bill of sale, certificate of merger, contract, deed, agreement, or court decree.

(2) A certified copy of each resolution of the corporate parties' boards of directors authorizing the transfer of assets.

(3) A certified copy of the minutes of each corporate party's stockholder meeting necessary to approve the transfer of assets.

(4) An authenticated copy of the transferee's certificate and articles of incorporation, if a corporation was formed for the purpose of receiving the assets involved in performing the Government contracts.

(5) The opinion of legal counsel for the transferor and transferee stating that the transfer was properly effected under applicable law and the effective date of transfer.

(6) Balance sheets of the transferor and transferee as of the dates immediately before and after the transfer of assets, audited by independent accountants.

(7) Evidence that any security clearance requirements have been met.

(8) The consent of sureties on all contracts listed under paragraph (e)(2) of this section if bonds are required, or a statement from the transferor that none are required.

(g) If the Government has acquired the documents during its participation in the pre-merger or pre-acquisition review process, or the Government's interests are adequately protected with an alternative formulation of the information, the responsible contracting officer may modify the list of documents to be submitted by the contractor.

(h) When recognizing a successor in interest to a Government contract is consistent with the Government's interest, the responsible contracting officer shall execute a novation agreement with the transferor and the transferee. It shall ordinarily provide in part that --

(1) The transferee assumes all the transferor's obligations under the contract;

(2) The transferor waives all rights under the contract against the Government;

(3) The transferor guarantees performance of the contract by the transferee (a satisfactory performance bond may be accepted instead of the guarantee); and

(4) Nothing in the agreement shall relieve the transferor or transferee from compliance with any Federal law.

Novation is a straight-forward process that can be accomplished in conjunction with a § 363 sale and is often a desirable result both for the debtor and the government, as the debtor is able to return value for the estate and the Government receives uninterrupted service. The special considerations in no way prevent a government contractor from filing a bankruptcy and reorganizing its business but they do require special analysis in the context of deciding whether to file and developing a reorganization plan.

Faculty Biographies

Lawrence P. Block is a partner with Stinson Leonard Street in Washington, D.C., and specializes in bankruptcy and creditors' rights, government contract consultation and business litigation. He represents large and small contractors, 8(a) contractors, nonprofit organizations and individuals in government contract matters related to federal and state agencies. Mr. Block has litigated pre-award and post-award government contract matters before boards of contract appeals, the General Accounting Office, the Court of Federal Claims and the SBA Office of Hearing and Appeals, as well as state and federal district courts. In addition, he consults with contractors daily on administrative and performance issues relating to government contracts, including the applicability of federal procurement regulations, evaluations of solicitations, drafting bids, joint venture and teaming agreements, disputes, claims, requests for equitable adjustment, use of subcontractors, size appeals, assisting with DCAA audits, defense of debarment/suspensions, and fulfillment of minority subcontracting requirements. Mr. Block is admitted to practice in Maryland, the District of Columbia and Virginia, and in the Fourth Circuit and Federal Courts of Appeals, as well as the Court of Federal Claims. He is a member of the American Bar Association's Public Contract Law and Litigation Sections, ABI and the Bankruptcy Bar Association of Maryland, and he has been recognized in the Washington, D.C., edition of *Super Lawyers* in the Government Contracts category (2013) and as one of *Washingtonian Magazine*'s "Best Legal Minds" (2013). Mr. Block received his B.A. in American history and political science from Connecticut College in 1991 and his J.D. from George Washington Law School in 1995.

Hilary S. Cairnie is a partner with BakerHostetler in Washington, D.C., where he focuses his practice on public contract law, which encompasses virtually all aspects of government contract law including contract formation, performance, administration, and enforcement controversies at the federal and state levels. He represents clients in the aerospace, automotive, shipbuilding, transportation, construction, software, medical and health care, engineering, and research and development industries, among others, and negotiates and prepares technology licensing agreements involving patents and trade secrets, copyrights and trademarks. Mr. Cairnie counsels clients on the unique issues associated with conceptualization and reduction to practice of inventions developed under publicly funded procurement contracts and other agreements, inventions, technical data, computer software and other works. He also advises clients on the pros and cons of using existing patents and inventions in connection with the performance of government contracts, and he negotiates terms and conditions for their use in meeting government requirements. Mr. Cairnie is a frequent speaker and has appeared regularly before various local, regional and national chapters of the National Contract Management Association (NCMA) and other trade associations. He received his B.S. in material science engineering from Purdue University in 1978, his S.M. in material science engineering from Massachusetts Institute of Technology in 1981, and his J.D. from Catholic University of America Columbus School of Law in 1989, where he was a staff member of the *Journal of Contemporary Health Law and Policy*.

Hon. Thomas J. Catliota is a U.S. Bankruptcy Judge for the District of Maryland in Greenbelt. Prior to his appointment in 2006, he was a partner in the firm of Pillsbury Winthrop Shaw Pittman and a member of its insolvency group, where he represented debtors, creditors and committees in bankruptcy courts across the country and focused on all aspects of insolvency law, with broad experience in real estate, technology, health care and other bankruptcy cases. Judge Catliota lectures frequently on many bankruptcy topics, including landlord/tenant rights in bankruptcy, the acquisition of assets from a bankruptcy estate and the law of letters of credit in bankruptcy. From 1993-96, he was the co-editor of *The Fourth Circuit and District of Columbia Bankruptcy Court Reporter*,

which contained the full text, synopses and summaries of bankruptcy court opinions published in the federal courts of the Fourth Circuit and the District of Columbia Circuit. Judge Catliota received his B.S. from Marquette University in 1977, his J.D. from Catholic University of America Columbus School of Law in 1983, where he was the recipient of the Faculty Award among other academic awards, and his LL.M. from Georgetown University Law Center in 1985.

Christopher J. Giaimo is a partner in the Washington, D.C., office of BakerHostetler, where he concentrates his practice in the areas of bankruptcy and creditors' rights, as well as litigation, representing secured and unsecured creditors, vendors and committees. He also represents investors seeking to acquire the distressed debt and assets of bankrupt and insolvent businesses, as well as the contractual interests of publicly and privately held companies in bankruptcy proceedings. Mr. Giaimo has bankruptcy experience in the real estate, lending, telecommunications and retail industries, among others, and his litigation practice includes complex valuation and avoidance action litigation. He is a member of ABI and is admitted to the District of Columbia, Maryland and New York Bars Associations, and he has chaired the Bankruptcy Committee of the Washington, D.C. Bar Association's Corporation, Finance & Securities Law Section. Mr. Giaimo received his B.S. from St. Joseph's University and his J.D. *cum laude* from St. John's University School of Law in 1995.

Prof. Sally McDonald Henry is an assistant professor at Texas Tech University School of Law in Lubbock, Texas, where she teaches commercial law, advanced bankruptcy and banking law. Prior to joining the faculty at Texas Tech, she was a partner in the corporate restructuring department of Skadden, Arps, Slate, Meagher & Flom LLP, where her practice included serving as counsel for a number of debtors and creditors in high-profile cases throughout the U.S. Prof. Henry has served as counsel to the debtor-in-possession or trustee in retail reorganization cases, real estate development cases, commodity trading cases and manufacturing cases, among others. She has also represented secured and unsecured creditors and distressed-asset purchasers in numerous high-stakes matters. Prof. Henry co-authored *Ordin on Contesting Confirmation*, published by Wolters Kluwer, and edited the annual *Portable Bankruptcy Code and Rules*, published by the American Bar Association, among others. In addition, in 2003 she won an award from the Legal Aid Society of New York for her outstanding pro bono work. Prof. Henry is admitted to practice in the State of New York and the Southern District of New York, as well as before a number of federal appeals courts. She received her undergraduate degree from Duke University and her J.D. from New York University School of Law, where she won several awards for her scholarship.

Janet M. Nesse is a partner in the Washington, D.C., office of Stinson Leonard Street and currently serves as chapter 7 and chapter 11 trustee in numerous bankruptcy matters, primarily in the District of Maryland. She focuses on bankruptcy and creditors' rights, business litigation, construction and government contracts, and represents secured and unsecured creditors, pursuing claims in the bankruptcy and workout context. Ms. Nesse's practice includes representations of debtors as well, both in bankruptcy matters and in guiding companies experiencing financial challenges through the workout process. She has been involved in the purchases of claims, hostile takeovers in the bankruptcy context and the pursuit of creditor plans, and also works on matters involving government contractors, including companies owned by minority and disadvantaged individuals. Ms. Nesse is a member of ABI, the Maryland Bankruptcy Bar Association, and the Womens' Bar Associations of Maryland, Virginia and the District of Columbia. She is admitted to practice in the

District of Columbia, Maryland, Virginia, the U.S. District Courts for the Districts of Columbia, Maryland and Virginia, and the U.S. Courts of Appeals for the Fourth Circuit and the District of Columbia Circuit. Ms. Nesse has been listed in *The Best Lawyers in America* for Bankruptcy and Creditor-Debtor Rights/Insolvency and Reorganization Law, and in the Washington, D.C., edition of *Super Lawyers* for Bankruptcy and Creditor/Debtor Rights. She received her B.A. in English literature with honors in 1978 and her J.D. from the College of William and Mary in 1981, where she was a notes and comments editor of its law review and a member of an interscholastic moot court team.

Lawrence S. Sher is a partner in the Washington, D.C., office of Reed Smith LLP and a member of the firm's Global Regulatory Enforcement Group. He has been representing clients across diverse industries in "high stakes" litigation matters for more than two decades, having successfully tried several cases to judgment and argued in numerous state and federal courts, as well as before federal and state agencies, administrative law judges and arbitration tribunals. Mr. Sher's practice principally involves litigating or counseling clients to avoid litigation in complex commercial disputes, government contract disputes, bid protests, Contract Disputes Act (CDA) claims and appeals, and he has counseled clients on federal regulatory compliance issues. He is admitted to practice in the District of Columbia, New York and Colorado, and before the U.S. Supreme Court, the U.S. Courts of Appeals for the District of Columbia and Federal Circuits, the U.S. District Courts for the District of Columbia, Maryland, and the Eastern and Southern Districts of New York, and the Superior Court of the District of Columbia. Mr. Sher received his B.A. *cum laude* in 1986 from the University of Massachusetts at Amherst and his J.D. *cum laude* in 1989 from American University Washington College of Law.

Holly Emrick Svetz is a partner with Womble Carlyle Sandridge & Rice LLP in Tysons Corner, Va., where she specializes in issues associated with government contracts, with a focus on technology, intellectual property, and innovative forms of research and development grants, contracts and other agreements. Her experience includes government grant and contract compliance counseling and training; solicitation and proposal review and advice; counseling related to intellectual property, the Service Contract Act and ethics, bid protests and claims litigation at the Court of Federal Claims, Armed Services Board of Contract Appeals, Civilian Board of Contract Appeals, Government Accountability Office, Virginia and District of Columbia state and federal courts, personnel and facility security clearance issues and hearings; small business advice and protests; and advice regarding qualifications for Small Business Innovative Research agreements and other special programs for small businesses. Previously, Ms. Svetz served more than 10 years in the U.S. Air Force as a research engineer in a laboratory in development of digital flight control systems, as an assistant professor of astronautics at the United States Air Force Academy, and as a program manager in the F-22 and T-1 aircraft program offices. She also served on the governing Council for the Section of Public Contract Law for the American Bar Association from 2005-08. Ms. Svetz received her B.S. in aeronautical engineering from the United States Air Force Academy in 1980, her M.S. in aeronautical engineering from the Air Force Institute of Technology in 1983, her M.S. in systems engineering from the University of Southern California in 1987, and her J.D. from the George Washington University Law School in 1993, where she served on the *Journal of International Law and Economics*.