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COMPETING POLICIES IN BANKRUPTCY: THE GOVERNMENTAL EXCEPTION TO THE AUTOMATIC STAY

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Section 362(b)(4) of the Bankruptcy Reform Act of 1978 provides an exception to the automatic stay for governmental actions brought against a debtor to enforce police or regulatory powers. This article classifies and discusses the cases decided under this section by subject, paying particular attention to judicial discussions of the "tests" developed from the legislative history and from decisions under prior bankruptcy laws. The author also provides greater insight into the area by evaluating the competing federal and state interests in debtor-creditor relations and protection of the public health, safety, and welfare.

I. INTRODUCTION

The automatic stay provided by section 362(a)[1] of the Bankruptcy

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1. Title 11 U.S.C.A. § 362(a) provides as follows:

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78eee(a)(3)), operates as a stay, applicable to all entities, of—

(1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;

Reform Act of 1978[2] (the Code) is one of the fundamental protections afforded to debtors, principally because it gives them a respite from actions of creditors.[3] Additionally, the automatic stay protects the interests of creditors by eliminating the need for a race to pursue remedies against a debtor, thus facilitating the orderly administration of the debtor's estate.[4] The automatic stay embraces both formal and informal claims[5] or proceedings[6] brought by all entities[7] against the debtor[8] or the

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(2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;

(3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;

(4) any act to create, perfect, or enforce any lien against property of the estate;

(5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;

(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;

(7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and

(8) the commencement or continuation of a proceeding before the United States Tax Court concerning the debtor.

11 U.S.C.A. § 362(a) (West 1979 & Supp. 1985).

2. 11 U.S.C. §§ 101-1330 (1982).

3. H.R. REP. NO. 595, 95th Cong., 1st Sess. 340 (1977), *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963, 6297; S. REP. NO. 989, 95th Cong., 2d Sess. 54-55 (1978), *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5787, 5840-41. The reports state: "[The stay] stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove him into bankruptcy." *Id.*

4. H.R. REP. NO. 595, *supra* note 3, at 340, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963, 6297; S. REP. NO. 989, *supra* note 3, at 49, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5787, 5835. The reports state:

> The automatic stay also provides creditor protection. Without it, certain creditors would be able to pursue their own remedies against the debtor's property. Those who acted first would obtain payment of the claims in preference to and to the detriment of other creditors. Bankruptcy is designed to provide an orderly liquidation procedure under which all creditors are treated equally. A race of diligence by creditors for the debtor's assets prevents that.

Id.; *accord* Penn Terra Ltd. v. Department of Envtl. Resources, 733 F.2d 267, 271 (3d Cir. 1984).

5. The term "claim" was not defined in the Bankruptcy Act of 1898, but is given a broad definition under the new Bankruptcy Code as follows:

> "claim" means—
>
> (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or
>
> (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

11 U.S.C. § 101(4) (1982); *see also* Ohio v. Kovacs, 105 S. Ct. 705, 709 (1985) (debtor's obligation to comply with a state court injunction requiring clean-up of a hazardous waste disposal site was a liability on a claim subject to discharge under Bankruptcy Code).

6. 2 W. COLLIER, COLLIER ON BANKRUPTCY, § 362.04, at 362-27 (15th ed. Supp. 1984); *see* H.R. REP. NO. 595, *supra* note 3, at 340, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963, 6297; S. REP. NO. 989, *supra* note 3, at 50, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5787,

bankruptcy estate. Although the scope of the stay is broad, reaching all legal and equitable interests of the debtor,[9] it has certain limitations and exceptions.[10]

5836. The reports state: "All proceedings are stayed, including arbitration, license revocation, administrative, and judicial proceedings. Proceeding in this sense encompasses civil actions as well, and all proceedings even if they are not before governmental tribunals." *Id.*; *see also* Pizza of Hawaii, Inc. v. Department of Taxation (*In re* Pizza of Hawaii, Inc.), 12 Bankr. 796, 798 (Bankr. D. Hawaii 1981) (state Liquor Commission requirement that the debtor submit a tax clearance before Commission would issue a renewal of debtor's liquor license constituted a "proceeding" within the context of Code § 362(a)(1)).

7. Penn Terra Ltd. v. Department of Envtl. Resources, 733 F.2d 267, 271 (3d Cir. 1984). "Entity" is defined to include persons, estates, trusts, and governmental units. 11 U.S.C. § 101(14) (1982). "Person" is defined to include individuals, partnerships, and corporations. 11 U.S.C.A. § 101(33) (Supp. 1985); *see infra* note 30 for the definition of "governmental unit."

8. Title 11 U.S.C. § 101(12) (1982) defines "debtor" as a "person or municipality concerning which a case under this title has been commenced." On the other hand, third parties who are not debtors under the Code are generally not afforded protection by the stay. *See* Office of Surface Mining v. Sewanee Land, Coal & Cattle, Inc. (*In re* Sewanee Land, Coal & Cattle, Inc.), 34 Bankr. 696, 700 (Bankr. N.D. Ala. 1983) (bankruptcy court lacked jurisdiction to enjoin government suit against third party non-debtor mining without valid permit in contravention of federal statute). In *Sewanee*, the court stated that "[i]n order for a bankruptcy judge to assume jurisdiction over a matter concerning a nonbankrupt individual, there must be a substantial relationship between the matter in controversy and the bankruptcy case." *Id.* at 700. Also, property interests deemed outside the scope of section 541(a) of the Code, defining property of the estate, are beyond the jurisdiction of the bankruptcy court and the coverage of the automatic stay. The legislative history of § 541 indicates that the definition is intended to be given a broad interpretation:

> The scope of this paragraph is broad. It includes all kinds of property, including tangible or intangible property, causes of action (see Bankruptcy Act § 70a(6)), and all other forms of property currently specified in section 70a of the Bankruptcy Act § 70a, as well as property recovered by the trustee under section 542 of proposed title 11, if the property recovered was merely out of the possession of the debtor, yet remained "property of the debtor." The debtor's interest in property also includes "title" to property, which is an interest, just as are a possessory interest, or leasehold interest, for example.

H.R. REP. NO. 595, *supra* note 3, at 367, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963, 6323, S. REP. NO. 989, *supra* note 3, at 82, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5787, 5868. Examples of the broad scope of property of the estate include: Missouri v. United States Bankruptcy Court, 647 F.2d 768, 774 (8th Cir. 1981) (possession coupled with minute ownership interest in grain stored in warehouses); Coben v. Lebrun (*In re* Golden Plan, Inc.), 37 Bankr. 167, 170 (Bankr. E.D. Cal. 1984) (corporate name); Aegean Fare, Inc. v. Licensing Bd. (*In re* Aegean Fare, Inc.), 35 Bankr. 923, 927 (Bankr. D. Mass. 1983) (a liquor license). *But see* FTC v. R.A. Walker & Assoc., 37 Bankr. 608 (D.D.C. 1983) (assets acquired by fraud are not part of estate); D.H. Overmyer Telecasting Co. v. Lake Erie Communications (*In re* D.H. Overmyer Telecasting Co.), 35 Bankr. 400, 401 (Bankr. N.D. Ohio 1983) (FCC license was not property of the estate because it was merely a right granted by a government agency subject to restrictions on use, transfer, or assignment, and revocation in certain instances); Fintel v. Oregon (*In re* Fintel), 10 Bankr. 50, 51 (Bankr. D. Or. 1981) (corporate surety bond posted by the debtor to obtain a contractor's license was not property of the estate). Although state law defines interests in property, it is a matter of federal law whether the property, as defined, is treated as property of the estate. *E.g.*, *In re Golden Plan, Inc.*, 37 Bankr. at 169.

9. *See* Coben v. Lebrun (*In re* Golden Plan, Inc.), 37 Bankr. 167, 170 (Bankr. E.D. Cal. 1984); *In re* Farmers Markets, Inc., 36 Bankr. 829, 833 (Bankr. E.D. Cal. 1984); Briarcliff v. Briarcliff Tenants Ass'n (*In re* Briarcliff), 15 Bankr. 864, 866 (Bankr. D.N.J. 1981); 2 W. COLLIER, *supra* note 6, § 362.01, at 362-6.1.

10. There are eleven listed exceptions to the automatic stay, which are set forth at 11 U.S.C.A. § 362(b) as follows:

One significant limitation, set forth in section 362(b)(4) of the Code, excepts from the stay actions and proceedings by governmental units to enforce police or regulatory powers.[11] Courts have encountered difficul-

(b) The filing of a petition under section 301, 302, or 303 of this title, or of an application under section 5(a)(3) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78eee(a)(3)), does not operate as a stay—

(1) under subsection (a) of this section, of the commencement or continuation of a criminal action or proceeding against the debtor;

(2) under subsection (a) of this section, of the collection of alimony, maintenance, or support from property that is not property of the estate;

(3) under subsection (a) of this section, of any act to perfect an interest in property to the extent that the trustee's rights and powers are subject to such perfection under section 546(b) of this title or to the extent that such act is accomplished within the period provided under section 547(e)(2)(A) of this title;

(4) under subsection (a)(1) of this section, of the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power;

(5) under subsection (a)(2) of this section, of the enforcement of a judgment, other than a money judgment, obtained in an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power;

(6) under subsection (a) of this section, of the setoff by a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency of any mutual debt and claim under or in connection with commodity contracts, as defined in section 761(4) of this title, forward contracts, or securities contracts, as defined in section 741(7) of this title, that constitutes the setoff of a claim against the debtor for a margin payment, as defined in section 741(5) or 761(15) of this title, or settlement payment, as defined in section 741(8) of this title, arising out of commodity contracts, forward contracts, or securities contracts against cash, securities, or other property held by or due from such commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency to margin, guarantee, secure, or settle commodity contracts, forward contracts, or securities contracts;

(7) under subsection (a) of this section, of the setoff by a repo participant, of any mutual debt and claim under or in connection with repurchase agreements that constitutes the setoff of a claim against the debtor for a margin payment, as defined in section 741(5) or 761(15) of this title, or settlement payment, as defined in section 741(8) of this title, arising out of repurchase agreements against cash, securities, or other property held by or due from such repo participant to margin, guarantee, secure or settle repurchase agreements;

(8) under subsection (a) of this section, of the commencement of any action by the Secretary of Housing and Urban Development to foreclose a mortgage or deed of trust in any case in which the mortgage or deed of trust held by the Secretary is insured or was formerly insured under the National Housing Act and covers property, or combinations of property, consisting of five [or] more living units;

(9) under subsection (a) of this section, of the issuance to the debtor by a governmental unit of a notice of tax deficiency; or

[10] under subsection (a) of this section, of any act by a lessor to the debtor under a lease of nonresidential real property that has terminated by the expiration of the stated term of the lease before the commencement of or during a case under this title to obtain possession of such property;

[11] under subsection (a) of this section, of the presentment of a negotiable instrument and the giving of notice of and protesting dishonor of such an instrument.

11 U.S.C.A. § 362(b) (West 1979 & Supp. 1985).

11. *See* H.R. REP. NO. 595, *supra* note 3, at 343, *reprinted in* 1978 U.S. CODE CONG. & AD.

ties in resolving the inherent conflicts presented by the competing policies of the Code of protecting debtors from creditor actions, while at the same time protecting the public from debtor conduct impacting health, welfare, and safety.[12] Courts, in applying section 362(b)(4), have fashioned several tests which address the purpose of the governmental unit's proceeding and its effect on the bankruptcy estate. These tests, however, are not drawn from a literal reading of the exception, but principally have been crafted from case law under the prior bankruptcy laws, from the legislative history of the Code, and from some result-oriented judicial engineering. As a result, an increasingly large body of case law has become riddled with inconsistencies and occasional unfortunate results.

The purpose of this article is to provide a roadmap through the tests used with respect to the governmental exception and to identify areas in which the tests function effectively or inadequately. In order to aid this analysis, cases which have dealt with section 362(b)(4) have been grouped according to the general subject matter involved, including land use, health and safety, labor, financial integrity, and securities regulation. These categories, although imprecise, are also helpful in understanding the underlying policy considerations involved in applying the governmental exception to the stay, particularly since policy concerns which have significance in one context may have little relevance to another type of governmental proceeding.

Interpretation of the stay and the governmental exception centrally involves questions of federal supremacy and pre-emption, reflecting an express waiver of sovereign immunity of the federal government balanced against an assertion of the federal bankruptcy power over state government under the supremacy clause.[13] In that regard, two governmental policies come into conflict in evaluating the applicability of the stay: the federal bankruptcy policy encouraging preservation and protection of the debtor's assets and equitable distribution to creditors versus the state po-

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NEWS 5963, 6299; S. REP. NO. 989, *supra* note 3, at 52, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5787, 5838. The reports state:

> Paragraph (4) excepts commencement or continuation of actions and proceedings by governmental units to enforce police or regulatory powers. Thus, where 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.

Id.

12. Penn Terra Ltd. v. Department of Envtl. Resources, 733 F.2d 267, 269 (3d Cir. 1984).

13. H.R. REP. NO. 595, *supra* note 3, at 342-43, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963, 6298-99; S. REP. NO. 989, *supra* note 3, at 51-52, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5787, 5837-38; *see also Penn Terra*, 733 F.2d at 272.

lice or regulatory laws which impact upon the debtor or the debtor's estate.[14]

The section 362(b)(4) exception to the stay gives the government a "super-priority"[15] in access to the appropriate court to enforce laws promoting public health and welfare, but is not intended to give the government any priority or preferential treatment over other creditors of the estate with respect to pecuniary matters.[16] The effect of the exception is to shift the burden of requesting relief away from the excepted governmental unit onto the debtor or bankruptcy trustee.[17] If a governmental proceeding is not excepted from the automatic stay pursuant to section 362(b)(4), the stay may still be vacated or modified by the court for "cause" pursuant to section 362(d)(1) of the Code. This situation arises when the balance of competing interests shifts away from protecting the debtor toward advancing other more pressing policy concerns.[18]

If a debtor believes that improprieties exist in the manner in which the governmental agency conducted a proceeding excepted from the stay, the debtor may only challenge the actions according to state law in a state court forum.[19] Actions which are taken in violation of the stay, however, are void,[20] and an intentional disregard of the automatic stay may result in a finding of civil contempt.[21]

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14. *Penn Terra*, 733 F.2d at 269; Donovan v. TMC Indus., 20 Bankr. 997, 1001 (Bankr. N.D. Ga. 1982).

15. *Donovan*, 20 Bankr. at 1005.

16. *Id.*; *accord* Missouri v. United States Bankruptcy Court, 647 F.2d 768, 776 (8th Cir. 1981).

17. Marshall v. Tauscher (*In re* Tauscher), 7 Bankr. 918, 920 (Bankr. E.D. Wis. 1981).

18. Title 11 U.S.C. § 362(d)(1) provides:

> (d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay—
>
> (1) for cause, including the lack of adequate protection of an interest in property of such party in interest . . . .

11 U.S.C. § 362(d)(1) (1982).

19. Herr v. Maine (*In re* Herr), 28 Bankr. 465, 466 n.2 (Bankr. D. Me. 1983); *In re* Alessi, 12 Bankr. 96, 97 (Bankr. N.D. Ill. 1981); *In re* Cousins Restaurants, Inc., 11 Bankr. 521, 522 (Bankr. W.D.N.Y. 1981).

20. Coben v. Lebrun (*In re* Golden Plan, Inc.), 37 Bankr. 167, 170 (Bankr. E.D. Cal. 1984).

21. Hill v. Farmers Home Admin. (*In re* Hill), 19 Bankr. 375, 379 (Bankr. N.D. Tex. 1982). In *Hill*, the court stated:

> Civil contempt remedies fall into two broad categories. It is remedial in that its purpose is to make a recalcitrant party comply with an order of the court. It is compensatory in that its purpose is to reimburse an injured party for losses and expenses incurred, because of the adversary's noncompliance.

Id. at 379; *see also In re* Sandmar Corp., 12 Bankr. 910 (Bankr. D.N.M. 1981) (agents of Indian tribe, who had actual notice of debtor-lessee's Chapter 11 filing, were found in civil contempt for forceably obtaining debtor's property following his default in lease obligations). *But see* Revere Copper Products, Inc. v. Hudson River Sloop Clearwater, Inc. (*In re* Revere Copper & Brass, Inc.), 29 Bankr. 584 (Bankr. S.D.N.Y. 1983). In *Revere*, the court declined to hold a citizen's group in civil

Most courts, following the legislative history to section 362(b)(4), have narrowly construed the exception.[22] However, in *Penn Terra Ltd. v. Department of Environmental Resources*,[23] the United States Court of Appeals for the Third Circuit relied upon the notion that federal preemption of state law involving police or regulatory matters should not be lightly inferred[24] and thus adopted a broad construction of that exception.[25] The Third Circuit's position, admittedly in contravention of applicable legislative history,[26] stands as an isolated result against the great weight of authority and creates an element of uncertainty in an area already difficult to define.

Also, several courts have further narrowed the section 362(b)(4) exception to only those exercises of police power which are "urgently" needed to protect the public health, safety, or welfare.[27] In one case, the

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contempt for commencing an action against the debtor for alleged violations of federal environmental law and stated, "[i]t is within the sound discretion of the court to refuse to hold persons in contempt for a violation of the automatic stay. . . . The contempt power is an awesome one and should be reserved for actions showing a more clearly contumacious frame of mind." *Id.* at 588-89 (citations omitted).

22. The legislative history with respect to construing section 362(b)(4) is as follows:

> Section 362(b)(4) indicates that the stay under section 362(a)(1) does not apply to affect the commencement or continuation of an action or proceeding by a governmental unit to enforce the governmental unit's police or regulatory power. This section is intended to be given a narrow construction in order to permit governmental units to pursue actions to protect the public health and safety and not to apply to actions by a governmental unit to protect a pecuniary interest in property of the debtor or property of the estate.

124 CONG. REC. H11,089 (1978) (statement of Rep. Edwards), *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 6436, 6444-45; 124 CONG. REC. S17,406 (1978) (statement of Sen. DeConcini), *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 6505, 6513. For cases discussing these statements, see *In re* Kennise Diversified Corp., 34 Bankr. 237, 242 (Bankr. S.D.N.Y. 1983); Eisenberg v. Incorporated Village of Mineola (*In re* IDH Realty, Inc.), 16 Bankr. 55, 57 (Bankr. E.D.N.Y. 1981); Schatzman v. Department of Health & Rehab. Serv. (*In re* King Memorial Hosp.), 4 Bankr. 704, 708 (Bankr. S.D. Fla. 1980); *see also* 2 W. COLLIER, COLLIER BANKRUPTCY MANUAL, § 362.04, at 362-23 (3d ed. Supp. 1984).

23. 733 F.2d 267 (3d Cir. 1984).

24. *Id.* at 272-73. The court stated:

> While Congress, under its Bankruptcy power, certainly has the constitutional prerogative to pre-empt the States, even in their exercise of police power, the usual rule is that congressional intent to pre-empt will not be inferred lightly. Pre-emption must either be explicit, or compelled due to an unavoidable conflict between the state law and the federal law. Consideration of whether a state provision violates the supremacy clause starts with the basic assumption that Congress did not intend to displace state law.
>
> Proper respect, therefore, for the independent sovereignty of the several States requires that federal supremacy be invoked only where it is clear that Congress so intended. Statutes should therefore be construed to avoid pre-emption, absent an unmistakable indication to the contrary.

Id. (citations omitted).

25. *Id.* at 273.

26. *Id.* at 274 n.6.

27. Eisenberg v. Incorporated Village of Mineola (*In re* IDH Realty, Inc.), 16 Bankr. 55, 57 (Bankr. E.D.N.Y. 1981); Schatzman v. Department of Health & Rehab. Serv. (*In re* King Memorial Hosp.), 4 Bankr. 704, 708 (Bankr. S.D. Fla. 1980).

court placed heavy emphasis on evidence showing that the governmental unit lacked diligence in instituting its action against the debtor.[28] The court found that protecting the public health and welfare was not the state's overriding motive in instituting the action, but that the state was apparently motivated by matters relating to the debtor's financial difficulties.[29] To some extent, then, this may simply be a rephrasing of the pecuniary purpose test. A requirement of urgency, though, imposes an undue burden of proof upon an otherwise valid exercise of a governmental unit's police power.

An initial inquiry in application of section 362(b)(4) is whether the action or proceeding is brought by a "governmental unit."[30] The most definitive examination of this threshold requirement appears in *Revere Copper Products, Inc. v. Hudson River Sloop Clearwater, Inc. (In re Revere Copper & Brass, Inc.)*,[31] in which a citizen's group instituted a suit, as private attorney general, against the debtor for alleged violations of the Clean Water Act.[32] The bankruptcy court, basing its decision upon applicable legislative history,[33] held that the section 362(b)(4) exception excludes such private attorney general actions.[34] In contrast, in *Illinois*

28. *King Memorial Hosp.*, 4 Bankr. at 708.

29. *Id.*

30. The term "governmental unit" is defined in § 101(24) 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." 11 U.S.C.A. § 101(24) (West Supp. 1985). Also, note that section 362(b)(4) dovetails to some extent with the removal statute, 28 U.S.C.A. § 1452, which provides that civil actions brought by a governmental unit to enforce its police or regulatory power are expressly excluded from being removed. The latter provision states:

> (a) A party may remove any claim or cause of action in a civil action other than a proceeding before the United States Tax Court or a civil action by a governmental unit to enforce such governmental unit's police or regulatory power, to the district court for the district where such civil action is pending, if such district court has jurisdiction of such claim or cause of action under section 1334 of this title.
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> (b) The court to which such claim or cause of action is removed may remand such claim or cause of action on any equitable ground. An order entered under this subsection remanding a claim or cause of action, or a decision to not remand, is not reviewable by appeal or otherwise.

28 U.S.C.A. § 1452 (West Supp. 1985). In applying the former removal statute, the following did not constitute "civil actions" and were thus not removable: Caldwell v. Internationale Resort & Beach Club (*In re* Internationale Resort & Beach Club), 36 Bankr. 189, 192 (Bankr. D.S.C. 1983) (arbitration action before state real estate commission); NLRB v. Adams Delivery Serv. (*In re* Adams Delivery Serv.), 24 Bankr. 589, 592 (Bankr. 9th Cir. 1982) (NLRB backpay liquidation action).

31. 29 Bankr. 584 (Bankr. S.D.N.Y. 1983).

32. *Id.* at 585.

33. *Id.* at 587. "Entities that operate through state action such as through the grant of a charter or license, and have no further connection with the state or federal government are not within the contemplation of the definition." *Id.* (quoting H.R. REP. NO. 595, *supra* note 3, at 311; S. REP. NO. 989, *supra* note 3, at 24).

34. *Id.* at 587-88; *see also In re* Colin, Hochstin Co., 41 Bankr. 322, 324 (Bankr. S.D.N.Y.

v. Electrical Utilities,[35] a state suing under the "private citizens" provision of a federal environmental statute was deemed a governmental unit within the meaning of section 362(b)(4), as the court stated that the exception focused on the identity of the plaintiff instead of the statute creating the cause of action.[36]

Assuming that an action involves a governmental unit, two primary tests are used with respect to the purpose of the government's proceeding to determine whether the section 362(b)(4) exception is available. The first test evaluates whether the government proceeding is to enforce laws affecting the public health and welfare or is instead to obtain a pecuniary benefit for the government in preference to other creditors of the bankruptcy estate. The second test focuses on whether the proceeding essentially involves matters affecting public policy or instead concerns the adjudication of private rights. If a government's action has satisfied both the pecuniary purpose and public policy tests, some courts have considered the effect of the governmental action on the debtor's estate—inquiring whether the proceeding poses such a threat to the estate's assets that the court, for countervailing policy considerations, would be justified in enjoining the action pursuant to the court's equitable discretion under section 105(a) of the Code.

A. *Pecuniary Purpose Test*

The "pecuniary purpose test" is phrased in the negative in that pro-

1984) (New York Stock Exchange was not considered a governmental entity within purview of § 362(b)(4)); Continental Airlines v. National Mediation Bd. (*In re* Continental Airlines), 40 Bankr. 299, 305 (Bankr. S.D. Tex. 1984) (National Mediation Board was not considered a governmental unit within the meaning of § 362(b)(4) because the Board had no enforcement function); *In re* Sandmar Corp., 12 Bankr. 910, 916 (Bankr. D.N.M. 1981) (court acknowledged that the Navajo Indian Tribe is arguably a governmental entity, but still would not receive a blanket exemption from automatic stay by that status—the court would inquire into the purpose behind any actions brought by the entity); *In re* J.J. Bradley & Co., 6 Bankr. 529, 538 (Bankr. E.D.N.Y. 1980) (court in dicta noted that the National Association of Securities Dealers, being a private organization, would not be characterized as a governmental unit for purposes of § 362(b)(4), irrespective of any close working association with the SEC). *But see* Swan v. Dervos (*In re* Dervos), 37 Bankr. 731 (Bankr. N.D. Ill. 1984) (the court relied upon *In re* Briarcliff and stated that it was not fatal to a complaint filed under § 362(b)(4) that the complaint was not actually filed by a governmental unit). This reliance appears misplaced in light of the legislative history to 11 U.S.C. § 101(24) (*see supra* note 30), particularly since *Briarcliff* was a Chapter XII arrangement under the Bankruptcy Act of 1898 and thus did not involve construction of section 101(24) or 362(b)(4) of the Code. *See also* D.H. Overmyer Telecasting Co. v. Lake Erie Communications (*In re* D.H. Overmyer Telecasting Co.), 35 Bankr. 400, 403 (Bankr. N.D. Ohio 1983) ("If the actions of regulatory agencies were exempt from the stay, private petitions invoking the authority of the regulatory agency were also exempt.").

35. 41 Bankr. 874 (Bankr. N.D. Ill. 1984).

36. *Id.* at 876. The court also noted that § 362(b)(4) did not distinguish between a state action brought under a state law and one under federal law. *Id.* at 876-77.

ceedings brought by governmental units may fall within the section 362(b)(4) exception only when they involve matters affecting the public health and welfare. The test contrasts proceedings in which governmental units attempt to exercise their police power in a manner that interferes with property of the estate or that prefers or injures creditors.[37] This test has received such increased attention by courts applying section 362(b)(4), that it may be considered the linchpin of whether a governmental proceeding is excepted from the automatic stay.

The pecuniary purpose test has been derived in part from language in the legislative history to section 362(b)(4)[38] and also from the case of *Perez v. Campbell.*[39] In *Perez,* the Supreme Court addressed the conflict between an Arizona statute which imposed certain financial responsibility requirements on the bankruptcy debtors and the Bankruptcy Act provisions and policy which gave debtors a full discharge from obligations in order to have a new start unhampered by preexisting debts.[40] The Court held[41] that, to the extent that the state law effectively frustrated the discharge granted to the debtors under the federal bankruptcy laws, the state law would be deemed violative of the supremacy clause of the United States Constitution.[42]

Examples of the varied instances in which the pecuniary purpose test has been applied to governmental unit proceedings, resulting in a denial of the section 362(b)(4) exception, include: a state department of agriculture attempt to operate and liquidate insolvent grain warehouses,[43] an attempt to condition the transfer of a debtor's liquor license upon payment of delinquent taxes,[44] an administrative proceeding in regard to the debtor's medicaid reimbursement entitlements,[45] an action to obtain funds from an escrow account established by the debtor as a com-

37. *In re* Farmers Markets, Inc., 36 Bankr. 829, 833 (Bankr. E.D. Cal. 1984); *In re* Rath Packing Co., 35 Bankr. 615, 621 (Bankr. N.D. Iowa 1983); Aegean Fare, Inc. v. Licensing Bd. (*In re* Aegean Fare, Inc.), 35 Bankr. 923, 927 (Bankr. D. Mass. 1983); Greenwald v. Axelrod (*In re* Greenwald), 34 Bankr. 954, 956-57 (Bankr. S.D.N.Y. 1983); Herr v. Maine (*In re* Herr), 28 Bankr. 465, 468 (Bankr. D. Me. 1983); *In re* Mason, 18 Bankr. 817, 821 (Bankr. W.D. Tenn. 1982); Muzio v. Sampson (*In re* Sampson), 17 Bankr. 528, 530-31 (Bankr. D. Conn. 1982).

38. 124 CONG. REC. H11,089 (1978); 124 CONG. REC. S17,406 (1978); *see supra* note 22 for text of legislative history.

39. 402 U.S. 637 (1971).

40. *Id.* at 648-49.

41. *Id.* at 656.

42. U.S. CONST. art. VI, cl. 2.

43. Missouri v. United States Bankruptcy Court, 647 F.2d 768, 776 (8th Cir. 1981).

44. *In re* Farmers Markets, Inc., 36 Bankr. 829, 833 (Bankr. E.D. Cal. 1984).

45. Greenwald v. Axelrod (*In re* Greenwald), 34 Bankr. 954, 957 (Bankr. S.D.N.Y. 1983).

pletion guarantee of a land development project,[46] and the revocation of a debtor's self-insurance status by a state insurance commissioner based upon the debtor's insolvency.[47]

Conversely, an administrative proceeding by a state board of medical quality assurance for revocation of a physician's license involving allegations of gross negligence and fraudulent financial dealings was deemed a valid exercise of police and regulatory power, rather than the mere protection of a governmental pecuniary interest.[48] Also, a state board's denial of a debtor's license to race horses because the debtor failed to meet certain financial responsibility requirements was determined by judicial notice to be a proper enforcement of the state's police power.[49]

B. *Public Policy Test*

A second, but seldom used, test applied by courts in determining whether a particular governmental proceeding against a debtor is excepted from the automatic stay is loosely termed the "public policy test."[50] This test provides that when a governmental agency does not attempt to effectuate public policy, but instead seeks to adjudicate private rights, the section 362(b)(4) exception is inapplicable.[51]

For example, proceedings before the NLRB have aspects of private litigation because they are commenced by aggrieved individuals, but one court has determined that the purpose of such proceedings primarily involves public policy considerations.[52] In contrast, proceedings before a state motor vehicle commission concerning termination of a franchise agreement were held principally to affect only the rights of private parties rather than the general public and were thus subject to the automatic stay.[53] Therefore, governmental proceedings which merely involve deter-

46. Heckler Land Dev. Corp. v. Township of Montgomery (*In re* Heckler Land Dev. Corp.), 15 Bankr. 856, 858 (Bankr. E.D. Pa. 1981).

47. *In re* Rath Packing Co., 35 Bankr. 615, 622 (Bankr. N.D. Iowa 1983).

48. Thomassen v. Division of Medical Quality Assurance (*In re* Thomassen), 15 Bankr. 907, 909 (Bankr. 9th Cir. 1981).

49. *In re* Alessi, 12 Bankr. 96, 98-99 (Bankr. N.D. Ill. 1981).

50. Herr v. Maine (*In re* Herr), 28 Bankr. 465, 468 (Bankr. D. Me. 1983).

51. Volkswagen of America, Inc. v. Dan Hixson Chevrolet Co. (*In re* Dan Hixson Chevrolet Co.), 12 Bankr. 917, 921 (Bankr. N.D. Tex. 1981).

52. D.M. Barber, Inc. v. Valverde (*In re* D.M. Barber, Inc.), 13 Bankr. 962, 963 (Bankr. N.D. Tex. 1981).

53. *Dan Hixson Chevrolet*, 12 Bankr. at 921-22. The court stated:

> A single agency may as to one function exercise judicial powers, and as to other and different functions exercise executive or legislative powers. The major consideration in determining whether an administrative agency is exercising a legislative or judicial function

minations of rights of private parties should be stayed, while actions relating to the enforcement of police or regulatory matters impacting the general public should pass the public policy test.[54] This point has seldom been articulated, but should be considered by courts in evaluating the purpose of the particular government proceeding against the debtor or the debtor's estate.

C. *Injunctions Under Section 105(a)*

Even if a particular proceeding by a governmental unit satisfies the pecuniary purpose and public policy tests, a bankruptcy court still has the discretion to enjoin the action pursuant to section 105(a) of the Code.[55] Courts have cautiously exercised this power, based upon the legislative history to section 105(a)[56] and upon case law under the prior

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is whether the agency's action concerns only parties who are immediately affected or a wider group of those subject to the authority of the agency or even the public as a whole. The chameleon-like character of the administrative agencies complicates the proper application of the automatic stay to their various activities.

Id. at 920 (citations omitted); *see also* Donovan v. LaPorta (*In re* LaPorta), 26 Bankr. 687, 691 (Bankr. N.D. Ill. 1982) (discussing functions of administrative agencies).

54. *Dan Hixson Chevrolet*, 12 Bankr. at 920. *But see* Ohio v. Mansfield Tire & Rubber Co. (*In re* Mansfield Tire & Rubber Co.), 660 F.2d 1108 (6th Cir. 1981). In that case the court stated:

> This court can find no basis of any distinction between the *enactment* of workers' compensation laws as a valid exercise of a state's police or regulatory power on the one hand, and the *administration* of claims arising under such laws as not being an exercise or extension of that power on the other.

Id. at 1113.

55. Section 105(a) provides: "The bankruptcy court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. § 105(a) (West Supp. 1985).

56. S. REP. NO. 989, *supra* note 3, at 51, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5787, 5837; H.R. REP. NO. 595, *supra* note 3, at 342, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963, 6298-99. The reports state:

> The court has ample other powers to stay actions not covered by the automatic stay. Section 105, of proposed title 11, derived from Bankruptcy Act § 2a(15), grants the power to issue orders necessary or appropriate to carry out the provisions of title 11. . . . Stays or injunctions issued under these other sections will not be automatic upon the commencement of the case, but will be granted or issued under the usual rules for the issuance of injunctions. By excepting an act or action from the automatic stay, the bill simply requires that the trustee move the court into action, rather than requiring the stayed party to request relief from the stay. There are some actions, enumerated in the exceptions, that generally should not be stayed automatically upon the commencement of the case, for reasons of either policy or practicality. Thus, the court will have to determine on a case-by-case basis whether a particular action which may be harming the estate should be stayed.
>
> With respect to stays issued under other powers, or the application of the automatic stay, to governmental actions, this section and the other sections mentioned are intended to be an express waiver of sovereign immunity of the Federal Government, and an assertion of the bankruptcy power over State governments under the Supremacy Clause notwithstanding a State's sovereign immunity.

Id.

Bankruptcy Act,[57] when it appears that the government proceeding poses a "threat to the assets" of the debtor's estate.[58] These cases are difficult to reconcile, particularly because they typically involve a balancing approach of relative hardships and because the underlying policy considerations are often either omitted or conclusory. As a result, the precedential value of these cases is limited and only serves to illustrate that a court's power to fashion an appropriate remedy is not limited to the terms of section 362. A discretionary stay, for example, has been issued to provide a trustee additional time to file a response to pending litigation to avoid a default judgment,[59] to enjoin a state agency from suspending or revoking the debtor's liquor license, necessary for an effective reorganization,[60] and to enjoin all acts of the NLRB with respect to the debtor other than the collection of information necessary to liquidate and file its claim in the bankruptcy estate.[61]

A court is not limited in utilizing section 105(a) to instances involving possession of property or a pending state court proceeding, but its availability enables the court to do whatever may be necessary relating to the bankruptcy case.[62] Therefore, the interplay between section 105(a) and section 362(b)(4) is often tenuous, as the courts place primary focus on the hardship to the debtor's estate rather than on the purpose or effect of the governmental proceeding. In short, section 105(a) is a type of last

57. *Id.*; *see* Shippers Interstate Serv., 618 F.2d 9, 13 (7th Cir. 1980); NLRB v. Jonas (*In re* Bel Air Chateau Hosp.), 611 F.2d 1248, 1251 (9th Cir. 1979).

58. 2 W. COLLIER, *supra* note 6, § 105.02, at 105-3; *see* Coben v. Lebrun (*In re* Golden Plan, Inc.), 37 Bankr. 167, 170 (Bankr. E.D. Cal. 1984); Donovan v. LaPorta (*In re* LaPorta), 26 Bankr. 687, 691 (Bankr. N.D. Ill. 1982); *In re* Mason, 18 Bankr. 817, 821 (Bankr. W.D. Tenn. 1982); D.M. Barber, Inc. v. Valverde (*In re* D.M. Barber, Inc.), 13 Bankr. 962, 965 (Bankr. N.D. Tex. 1981).

59. Hudtwalker v. United States Dep't of Energy (*In re* Vantage Petroleum Corp.), 25 Bankr. 471, 476 (Bankr. E.D.N.Y. 1982).

60. *In re* Mason, 18 Bankr. 817, 822 (Bankr. W.D. Tenn. 1982). *But see In re* Arnage, Inc., 33 Bankr. 662, 665 (Bankr. E.D. Mich. 1983).

61. D.M. Barber, Inc. v. Valverde (*In re* D.M. Barber, Inc.), 13 Bankr. 962, 965 (Bankr. N.D. Tex. 1981). One court, in issuing a discretionary stay pursuant to section 105(a), employed the same test that a federal court would use in granting a preliminary injunction:

> The standard in the Second Circuit for injunctive relief clearly calls for a showing of (a) irreparable harm and (b) either (1) likelihood of success on the merits or (2) sufficiently serious questions going to the merits to make them a fair ground for litigation and a balance of hardships tipping decidedly toward the party requesting the preliminary relief.

Hudtwalker v. United States Dep't of Energy (*In re* Vantage Petroleum Corp.), 25 Bankr. 471, 477 (Bankr. E.D.N.Y. 1982); *see also* Coben v. Lebrun (*In re* Golden Plan, Inc.), 37 Bankr. 167, 170 (Bankr. E.D. Cal. 1984) ("Before a court can issue a permanent injunction, the plaintiff must show that the defendant's actions will cause irreparable harm and that no adequate remedy at law exists.") (citation omitted).

62. 2 W. COLLIER, *supra* note 6, § 105.02, at 105-3. For a survey of cases involving § 105(a), see 2 W. COLLIER, COLLIER BANKRUPTCY PRACTICE GUIDE, § 39.03 (1st ed. 1981).

resort available to a debtor to halt a governmental proceeding that otherwise has a valid purpose.

D. *28 U.S.C. § 959*

In addition to the exception from the automatic stay afforded certain governmental proceedings, several courts have applied 28 U.S.C. § 959[63] to require a debtor to conduct its business operations in accordance with state law. This section has somewhat limited utility, however, because it has been held to apply only to the enforcement of state, and not federal laws,[64] and only covers acts by the debtor which occur after the bankruptcy petition is filed.[65] Section 959 has been utilized to ensure that a debtor-in-possession operated a quarry in compliance with state air pollution control laws,[66] to require that a third party non-debtor obtain a valid state permit to conduct surface mining operations,[67] to invoke application of local housing code ordinances with respect to buildings owned by the debtor,[68] and to form the basis for dismissal of a bankruptcy case when it was considered impossible for the trustee to manage the debtor's hazardous waste site in accordance with state law.[69]

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63. This section provides:

> (a) Trustees, receivers or managers of any property, including debtors in possession, may be sued, without leave of the court appointing them, with respect to any of their acts or transactions in carrying on business connected with such property. Such actions shall be subject to the general equity power of such court so far as the same may be necessary to the ends of justice, but this shall not deprive a litigant of his right to trial by jury.
>
> (b) Except as provided in section 1166 of title 11, a trustee, receiver or manager appointed in any cause pending in any court of the United States, including a debtor in possession, shall manage and operate the property in his possession as such trustee, receiver or manager according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof.

28 U.S.C. § 959 (1982).

64. Revere Copper Products, Inc. v. Hudson River Sloop Clearwater, Inc. (*In re* Revere Copper & Brass, Inc.), 29 Bankr. 584, 588 (Bankr. S.D.N.Y. 1983).

65. *Id.* Section 959 may be contrasted with section 362(b)(4), which does not turn on whether the police or regulatory power is exercised with respect to pre-petition or post-petition conduct of the debtor, but primarily involves the nature and purpose of the government's action. *In re* Kennise Diversified Corp., 34 Bankr. 237, 243 (Bankr. S.D.N.Y. 1983). In *Kennise*, however, the court found that a reasonable likelihood existed that certain pre-petition violations by the debtor would continue indefinitely into the future, thus justifying application of 28 U.S.C. § 959. *Id.* at 243.

66. *In re* Canarico Quarries, Inc., 466 F. Supp. 1333, 1339 (D.P.R. 1979).

67. Office of Surface Mining v. Sewanee Land, Coal & Cattle, Inc. (*In re* Sewanee Land, Coal & Cattle, Inc.), 34 Bankr. 696, 702 (Bankr. N.D. Ala. 1983).

68. *In re* Kennise Diversified Corp., 34 Bankr. 237, 243 (Bankr. S.D.N.Y. 1983).

69. *In re* Charles George Land Reclamation Trust, 30 Bankr. 918, 921 (Bankr. D. Mass. 1983).

II. APPLICATION OF SECTION 362(b)(4)

A. *Land Use*

An increasingly large body of case law has dealt with whether attempts by federal, state, and local agencies to force debtors to comply with zoning or environmental laws are excepted from the automatic stay under section 362(b)(4). The courts which have addressed such land use questions have often been faced with strong conflicting policy concerns—the Bankruptcy Code policy of giving the debtor a breathing spell from creditor actions versus protecting the public from a debtor conducting its business in a hazardous manner.

Historically, courts have not adequately separated, for section 362(b)(4) purposes, the underlying policy considerations according to the nature of the subject matter involved. One thesis submitted by this article is that the policy concerns which govern, for example, whether a debtor should be permitted to operate its business as a non-conforming use, have little relevance to another case in which a governmental agency seeks to prevent a debtor from polluting the environment. In each instance, courts have utilized the pecuniary purpose and public policy tests and sometimes have considered the effect of the governmental action, but additional analysis is required to tailor the inquiry according to the nature of the harm which the government seeks to remedy.

1. Environmental Protection

Bankruptcy courts have strongly favored permitting governmental units to proceed, under section 362(b)(4), with environmental protection actions against debtors. When such cases involve state and federal laws which require the expenditure of funds by debtors to clean up waste disposal sites or other types of land reclamation projects, an inherent conflict is presented in classifying the government's enforcement action as a proper police power function regarding environmental protection, as opposed to an improper taking of the debtor's property for the pecuniary benefit of the government.

A leading pre-Code case, *In re Canarico Quarries, Inc.*,[70] dealt with whether the bankruptcy court had jurisdiction to stay the Puerto Rico Environmental Quality Board from enforcing its regulations regarding air pollution against the operation of a quarry by the debtor-in-posses-

70. 466 F. Supp. 1333 (D.P.R. 1979).

sion.[71] Shortly before the debtor filed a petition under Chapter XI of the Bankruptcy Act, the Board issued a cease and desist order against the debtor's operation of the quarry for alleged violations of state regulations promulgated pursuant to the federal Clean Air Act.[72] The bankruptcy court, however, issued an order authorizing the debtor to continue operating its business.

On appeal, the district court recognized the conflicting policies at issue: that the primary purpose of the Clean Air Act was to protect the public from the dangers of air pollution, while one aim of the bankruptcy laws was to protect the debtor's property from creditor interference which might hinder the proper administration of the case.[73] The court resolved those conflicting policies by finding that the bankruptcy court had no express congressional authority to intervene in environmental matters, that the debtor's rehabilitation must be accomplished in compliance with applicable state laws, and that Chapter XI Rules were intended to be procedural in nature and were not meant to enlarge or modify substantive rights.[74] In other words, the bankruptcy court could not authorize the debtor to operate its business without the necessary state law permit.

Similarly, *Penn Terra Ltd. v. Department of Environmental Resources*[75] considered whether the Pennsylvania Department of Environmental Resources would be permitted, under section 362(b)(4), to enforce a state court injunction against the debtor with respect to certain state environmental laws.[76] The Department had obtained a post-petition injunction to correct violations of the state environmental laws and to enforce the terms of a pre-petition consent order establishing a plan for reclamation of the debtor's coal surface mines. The United States Court of Appeals for the Third Circuit reversed and remanded with directions that the bankruptcy court vacate its injunction against the Department.[77]

The Third Circuit recognized that the policies of the Bankruptcy Code with respect to preservation of the debtor's assets conflicted with the state environmental policies of protecting natural resources and cor-

71. *Id.* at 1339.
72. *Id.* at 1334.
73. *Id.* at 1337.
74. *Id.* at 1339.
75. 733 F.2d 267 (3d Cir. 1984).
76. *Id.* at 269. The Department had claimed violations by the debtor of the Pennsylvania Clean Streams Law and the Bituminous Coal Open Pit Mining Conservation Act. *Id.* n.1.
77. *Id.* at 279.

recting damage to the environment.[78] The court stated that interpretation of the automatic stay primarily involved questions of federal supremacy and pre-emption and that pre-emption would neither be inferred lightly nor favored.[79] The court reasoned that the term "police and regulatory powers" in section 362(b)(4) should be construed broadly[80] and determined that a government action to rectify harmful environmental hazards was a valid exercise of the state's police power.[81]

The court then held that an "enforcement of a money judgment," prohibited by section 362(b)(5) of the Code, was not indicated when the Department's injunction "was not intended to provide compensation for past injuries" and "was not reduceable [sic] to a sum certain."[82] The Third Circuit characterized as "unduly broad" the lower court's view that the definition of "money judgment" contemplated and encompassed anything which costs money to enforce.[83] The Third Circuit in *Penn Terra* disagreed with the Sixth Circuit's construction of the definition of "money judgment" in section 362(b)(5) in *Ohio v. Kovacs* (*In re Kovacs*).[84] In *Kovacs*, the Sixth Circuit held that a state court appointment of a receiver to take possession of the debtor's property and to clean up a hazardous waste site amounted to an "enforcement of a money judgment" within the meaning of section 362(b)(5) and automatically stayed the actions.[85] It is unclear which Circuit's approach will be followed, as the Supreme Court's decision in *Ohio v. Kovacs*[86] considered only whether the debtor's obligation to clean up the waste site was a "claim" dischargeable in bankruptcy. The Sixth Circuit's construction of "money judgment" appears to be the better view in light of the legislative

78. *Id.* at 269.
79. *Id.* at 272.
80. *Id.* at 273; *see supra* notes 22-25.
81. *Penn Terra*, 733 F.2d at 274.
82. *Id.* at 279; *see supra* note 10 for text of § 362(b)(5). The court explained that the section creates an "exception to the exception" under section 362(b)(4), in that actions to enforce money judgments are halted by the automatic stay even if they otherwise demonstrate a valid furtherance of the state's police power. *Penn Terra*, 733 F.2d at 272. The court cited with approval the following legislative history to section 362(b)(5):

> Paragraph (5) makes clear that the exception extends to permit an injunction and enforcement of an injunction, and to permit the entry of a money judgment, but does not extend to permit enforcement of a money judgment. Since the assets of the debtor are in the possession and control of the bankruptcy court, and since they constitute a fund out of which all creditors are entitled to share, enforcement by a government unit of a money judgment would give it preferential treatment to the detriment of all other creditors.

Id. at 272 (quoting H.R. REP. NO. 595, *supra* note 3, at 343; S. REP. NO. 989, *supra* note 3, at 52).
83. *Penn Terra*, 733 F.2d at 277.
84. 681 F.2d 454 (6th Cir. 1982), *vacated*, 459 U.S. 1167 (1983).
85. *Id.* at 456.
86. 105 S. Ct. 705 (1985).

history to section 362(b)(5)[87] and considering that a literalist approach to the phrase would virtually emasculate section 362(a)(2).

Similarly, *In re Charles George Land Reclamation Trust*[88] involved a governmental action to force clean-up of the debtor's hazardous waste site. As a result of a suit brought by the Commonwealth of Massachusetts through its Department of Environmental Quality Engineering, the debtor had agreed, prior to filing for bankruptcy relief, to the entry of a consent judgment which required it to pay a civil fine and to bring its waste disposal facility into compliance with applicable environmental laws. Additionally, a state court order compelled the debtor to make payments into a special trust account with withdrawals applied for payment of a groundwater hydrology study and for closure of the site. When the debtor defaulted in payment of its obligations and illegally discharged hazardous waste into a catch basin which drained into the source of drinking water for several communities, the trustee, joined by the Commonwealth and a township, moved for dismissal of the debtor's bankruptcy case.[89]

The court recognized the conflict between 28 U.S.C. § 959(b), which requires a trustee or debtor-in-possession to operate property in his possession in compliance with state laws, and the view that government actions should not be excepted from the automatic stay when they involve substantial expenditures by the debtor.[90] However, since the trustee could not comply with the applicable environmental laws and because the threat to the public welfare was serious and immediate, the court decided to dismiss the bankruptcy case.[91]

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87. *See supra* note 82.

88. 30 Bankr. 918 (Bankr. D. Mass. 1983).

89. *Id.* at 920.

90. *Id.* at 921 n.5; *see supra* note 63 for text of 28 U.S.C. § 959(b).

91. *Land Reclamation*, 30 Bankr. at 924-25. The court stated:

> This was not a bankruptcy case where assets could be liquidated, claims adjudicated and a distribution made within a relatively short period of time, but rather it was and is an ongoing environmental nuisance that threatens the health, safety and well-being of the people who surround it. The dismissal of this case was a recognition by this Court that the appropriate forum to redress and correct this environmental nuisance in the most expeditious and efficient manner was the State court. This Court had neither the resources, the expertise or, for that matter, a suitably qualified trustee with experience in hazardous waste management, to do other than to allow the resolution of this matter by the continuing efforts of the appropriate state court. The specter of a dividend in this case was not sufficient to justify the exposure of the surrounding populace to the possibility of a reoccurrence of another leachate discharge, similar to that which took place during the Debtor's Chapter 11 proceedings. Dismissal, with the concomitant elimination of the automatic stay, would allow the EPA and DEQE to assert their full panoply of powers under the Federal and State Superfund statutes.

Id. (footnote omitted).

The court in *Hudtwalker v. United States Department of Energy (In re Vantage Petroleum Corp.)*[92] took a different approach when faced with whether section 362(b)(4) applied to an administrative proceeding against the debtor by the DOE concerning pre-petition violations of certain federal gasoline price guidelines.[93] The court analyzed the goals of the federal legislation, determined that the regulations were a valid exercise of the government's police power,[94] and held that the DOE would not be stayed from liquidating its claim against the debtor absent an injunction issued pursuant to the bankruptcy court's equitable powers.[95]

Because the possible entry of a nonreviewable default judgment in favor of the DOE against the debtor was a sufficient threat to the estate, the court exercised its power pursuant to section 105 and granted the trustee additional time to file an appropriate response to the administrative action.[96] The court acknowledged that the "threat to the assets of the estate" test was satisfied by potential government agency enforcement actions rather than adjudicatory activities, but determined that section 105 could have a broader utility, particularly since section 362 automatically stayed enforcement activity.[97]

2. Zoning

In contrast to the predominant judicial view permitting governmental units to enforce environmental laws against debtors under section 362(b)(4), the majority of courts have determined that actions to enforce zoning laws against debtors are outside the scope of section 362(b)(4) and thus subject to the automatic stay. Perhaps the reason for this dichotomy is that the government's action is motivated by different policy concerns. While the harm to the public may be evident and immediate when a debtor is violating environmental laws, the policy of forcing a debtor to operate its business as a conforming use, for example, may be more read-

92. 25 Bankr. 471 (Bankr. E.D.N.Y. 1982).
93. *Id.* at 475.
94. *Id.*
95. *Id.* The court noted, however, that the DOE would be stayed from collecting on a judgment it might obtain without leave of court. Such leave would be inappropriate in this instance because it would cause the DOE or the public to receive a preference to other creditors of the bankruptcy estate. *Id.* n.9. *But see* United States v. Energy Int'l, Inc., 19 Bankr. 1020, 1021 (Bankr. S.D. Ohio 1981) (action by the Department of the Interior to collect a civil penalty assessed against the debtor for certain violations of the Surface Mining Control and Reclamation Act of 1977 was to enforce the government's regulatory power and therefore was within the § 362(b)(4) exception to the automatic stay). The holding in *Energy Int'l* seems to violate the pecuniary purpose test and should have been subject to the automatic stay, as the relief granted the Department was purely monetary.
96. *Vantage Petroleum*, 25 Bankr. at 476-77.
97. *Id.* at 476.

ily characterized as motivated by financial considerations than by a desire to protect the public.

For example, *Eisenberg v. Incorporated Village of Mineola (In re IDH Realty, Inc.)*[98] considered whether a municipality would be stayed from reclassifying the debtor's restaurant operations as a non-conforming use under its zoning code.[99] Approximately eleven years before filing its Chapter 7 petition, the debtor had been authorized by the municipality to construct and operate a restaurant as a permitted use under the zoning district classification. Several years later, the municipality amended its zoning code to change the restaurant operation from a permitted to a conditional use. One section of the zoning ordinance provided that cessation of operation of a non-conforming use for a period greater than six months was deemed an abandonment of the right to operate the non-conforming use, absent issuance of a special exception permit.[100] When the debtor filed its bankruptcy petition, only two months had run on the six-month grace period. The trustee sought to liquidate the debtor's assets approximately thirteen months after the debtor had ceased its restaurant operations. The trustee contended that the automatic stay tolled the six-month grace period and stayed the zoning enforcement.[101] The municipality asserted that the premises had been abandoned in excess of the six-month period, resulting in a forfeiture of the non-conforming use

98. 16 Bankr. 55 (Bankr. E.D.N.Y. 1981).

99. *Id.* at 57. A similar situation was presented in National Hosp. & Inst. Builders v. Goldstein (*In re* National Hosp. & Inst. Builders), 658 F.2d 39 (2d Cir. 1981), *cert. denied,* Goldstein v. Garrity, 454 U.S. 1149 (1982), decided under the Bankruptcy Act of 1898. In *Goldstein,* the court held that the New York City Department of Buildings was stayed from proceeding to revoke the certificate of occupancy for the debtor's nursing home. The city contended that the facility had become a nonconforming use after amendment of its zoning ordinances, thereby causing forfeiture of the debtor's certificate of occupancy when the business was not operated for two years. On remand of the city's motion for relief from the stay, the United States Court of Appeals for the Second Circuit held that the lower court should review the finding that the city was pursuing the revocation in bad faith. The court stated:

> Contrary to the City's assertions, it is neither unseemly nor unusual for the bankruptcy court to examine issues of state zoning law to determine whether the intended revocation is marred by procedural or substantive defects. We emphasize that the purpose of the bankruptcy laws—to allow the trustee without delay to marshal and administer the assets of the debtor—would be frustrated were state officials free to interfere with the administration of the bankrupt's estate through bad faith zoning regulation.

Goldstein, 658 F.2d at 44. The Second Circuit noted that bad faith involved more "than an erroneous determination of law or fact," but meant that the zoning law was unconstitutional, the forum was biased, the city wilfully disregarded the law, the city officials clearly abused their discretion in initiating proceedings against the trustee, or the proceedings were motivated by a desire to harass the debtor. *Id.*

100. *IDH Realty,* 16 Bankr. at 56.

101. *Id.* at 57.

status.[102]

The court stated that section 362(b)(4) was limited to the "enforcement" of police powers or regulatory law and that the derogation of local law must exist at the time the bankruptcy petition is filed for a municipality to enforce its zoning ordinances in spite of the automatic stay.[103] The court reasoned that since only two months of the abandonment period had elapsed at the date that the petition was filed, the municipality had no enforceable rights against the debtor.[104] As a consequence, the post-filing zoning reclassification was premature and untimely as an enforcement action and was therefore stayed.[105] Furthermore, the court stated that enforcement of the zoning statute was not the sort of exercise of police power "urgently" needed to protect the public health and welfare.[106]

Similarly, *Island Club Marina, Ltd. v. Lee County (In re Island Club Marina, Ltd.)*[107] dealt with whether the automatic stay would bar a county from changing its zoning density regulations applicable to some building permits obtained by the debtor pre-petition.[108] The debtor had obtained proper building permits for construction of a condominium complex and, in reliance upon the permits, had incurred substantial construction costs prior to filing its petition in bankruptcy. Several months after the debtor filed its petition, the county enacted a new zoning ordinance which reduced the maximum density of units allowed on the debtor's property.

The bankruptcy court concluded that section 362(b)(4) did not permit the county to change its zoning density regulations for the debtor's premises.[109] The court based its holding on several factors: that the county failed to demonstrate (1) that the purpose of the ordinance was to protect the health and safety of its residents; (2) that the zoning change was "urgently" needed to protect the public welfare; and (3) that the purpose of the action was not to protect a pecuniary interest in the

102. *Id.*

103. *Id.*

104. *Id.* The court stated that "[t]he running of the abandonment period . . . was the necessary contingent event to the creation of such a right." *Id.*

105. *Id.*

106. *Id.*; *see supra* text accompanying notes 27-29.

107. 38 Bankr. 847 (Bankr. N.D. Ill. 1984).

108. *Id.* at 854.

109. *Id. But see* Lacoquille Inv. Co. v. Town of Manalapan (*In re* Lacoquille Inv. Co.), 44 Bankr. 731, 733 (Bankr. S.D. Fla. 1984) (criticizing the narrow restriction placed on § 362(b)(4) by *Island Club Marina*).

debtor's estate.[110]

An egregious example of an improperly motivated governmental action under the guise of section 362(b)(4) was addressed in *Heckler Land Development Corp. v. Township of Montgomery (In re Heckler Land Development Corp.)*.[111] In *Heckler*, the debtor had entered into a land development agreement with a township several years before filing for relief under Chapter 11 of the Code.[112] As part of the development agreement and as required by the township's subdivision ordinance, the debtor had established an escrow account to serve as a completion guarantee account. When the debtor failed to finish the project, the township completed certain improvements at the project site. Subsequently, the township brought an action in state court seeking reimbursement from the escrow account for expenses incurred in connection with the improvements.

The court, based on the legislative history to section 362(b)(4),[113] stated that Congress had "intended to protect debtors from the collection efforts of governmental units and to preserve the assets of the estate for orderly administration while allowing governing bodies to enforce necessary measures to preserve the public health and welfare."[114] The court properly characterized the township's efforts to seek reimbursement as an attempt to collect an indebtedness, rather than an effort to enforce

110. *Island Club Marina*, 38 Bankr. at 853-54. The court stated that the debtor was protected by 11 U.S.C. § 525 from discriminatory treatment by a governmental unit. Section 525(a) provides, in pertinent part:

> [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 . . . a person that is or has been a debtor under this title or a bankrupt or a debtor under the Bankruptcy Act, or another person with whom such bankrupt or debtor 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) (West 1979 & Supp. 1985). Section 525(a), then, prohibits governmental units from discriminating against the debtor solely on the basis of the debtor's seeking relief under the Bankruptcy Code. The court in *Island Club Marina* stated that although an applicant's financial status was one factor which a licensing agency could evaluate in determining whether to grant a building permit, the agency could not refuse to grant a permit merely because the applicant had filed a bankruptcy petition. 38 Bankr. at 854. *But see* S. REP. No. 989, *supra* note 3, at 81, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5787, 5867 (Section 525 "does not prohibit consideration of other factors, such as future financial responsibility or ability, and does not prohibit imposition of requirements such as net capital rules, if applied nondiscriminatorily.").

111. 15 Bankr. 856 (Bankr. E.D. Pa. 1981).

112. *Id.* at 857.

113. *Id.* at 858 (citing H.R. REP. No. 595, *supra* note 3, at 342-43; S. REP. No. 989, *supra* note 3, at 51-52); *see supra* note 11 for text of legislative history.

114. *Heckler*, 15 Bankr. at 858.

public health, safety, or welfare requirements. Accordingly, the court found the action outside the exception of section 362(b)(4).[115]

On the other hand, the pecuniary purpose test was satisfied in *In re Cousins Restaurants, Inc.*,[116] where a town sought enforcement in state court of a local zoning ordinance which would require a debtor-in-possession to obtain a special use permit. The debtor had operated its property as a restaurant and had obtained the special permit required for restaurants. However, when the debtor changed operations to a night-club disco several months before filing a petition under Chapter 11 of the Code, it failed to obtain a new special use permit. The court held that the town's action to enforce its zoning laws was a proper exercise of a governmental unit's police or regulatory power and, therefore, not subject to the automatic stay.[117] The court further stated that if the debtor believed that the zoning requirement of a special use permit was arbitrary, then the proper forum for protection of the debtor's rights would be the state courts.[118] The court failed, however, to identify any public welfare concerns which would pass muster under the pecuniary purpose test and simply concluded that the zoning enforcement was valid. This type of conclusory analysis fails to recognize that the automatic stay is the general rule, while section 362(b)(4) is the exception and must be available only when necessary to advance interests affecting the public health, safety, or welfare.

B. *Health and Safety*

The cases which have dealt with the applicability of section 362(b)(4) in the context of health and safety laws are extremely diverse. Although these cases do not readily lend themselves to categorization, a significant number have involved the issue of whether the stay and injunctive powers of the bankruptcy court are sufficient or appropriate to prevent proceedings by state and local agencies to revoke or condition the continuance or renewal of various types of licenses held by debtors. The obvious importance of the licensing availability is that often the debtor must possess the license as a condition to the operation and rehabilitation of its business.

One general field in which courts have addressed the availability of

115. *Id.*
116. 11 Bankr. 521 (Bankr. W.D.N.Y. 1981).
117. *Id.* at 522.
118. *Id.*; *see supra* note 19.

section 362(b)(4) in the application of health and safety laws involves interpretations of medical board and hospital licensing. These cases present some interesting policy conflicts in that a threshold inquiry would support permitting the government to enforce health care laws for the protection of the public. When the issue does not deal directly with health care, but actually involves financial aspects of the debtor's business, then the pecuniary purpose test has been applied to stay the government's action.

In *Sisk v. Massachusetts (In re Saugus General Hospital)*,[119] decided under the Bankruptcy Act of 1898, the Massachusetts Department of Public Health notified the hospital to discontinue admitting patients and operating its emergency and surgical services until it had corrected certain administrative deficiencies.[120] Shortly after the Department's notification, an involuntary petition in bankruptcy was filed against the hospital.[121] Several weeks after the petition was filed, the Department notified the hospital that its license to operate had been terminated based on the hospital's discontinuance of its operations.[122] The bankruptcy receiver filed a complaint seeking a determination that the termination of the hospital's license violated the automatic stay of Bankruptcy Rule 11-44(a).[123] The receiver also asked the court to determine whether its previous injunction prohibited enforcement of the license revocation.[124] The court held that the termination of the hospital's license by the Department did not involve an exercise of the police power in furtherance of the public welfare, but was based instead on the hospital's financial difficulties,[125] and therefore was subject to the automatic stay.[126]

A similar approach was taken under the Code in *Schatzman v. Department of Health & Rehabilitative Services (In re King Memorial Hospital)*,[127] which concerned the validity of a determination by the Florida Department of Health and Rehabilitative Services that the debtor-hospital had forfeited its exemption from certificate of need review to construct a hospital.[128] The court found that the purpose of the state statutes, which were the basis for the agency's actions, was not to protect

119. 1 COLLIER BANKR. CAS. 2d 26 (Bankr. D. Mass. 1979).
120. *Id.* at 27.
121. *Id.*
122. *Id.*
123. *Id.*
124. *Id.*
125. *Id.* at 31-32.
126. *Id.* at 31.
127. 4 Bankr. 704 (Bankr. S.D. Fla. 1980).
128. *Id.* at 705.

health and welfare, but to establish community-oriented health goals that could be reevaluated by providers, consumers, and public agencies.[129] Additionally, the court noted that the agency's delay of several months in initiating the forfeiture proceedings indicated that there was not an "urgent" need to protect the public health and welfare.[130] The court held, therefore, that the Department was subject to the automatic stay because its proceedings were designed to protect a pecuniary interest in the debtor's property, rather than to protect the public health and safety.[131]

In *Greenwald v. Axelrod (In re Greenwald)*,[132] the New York State Department of Health sought relief from the automatic stay in order to complete administrative proceedings concerning the debtor's medicaid reimbursement entitlements.[133] The Department had the responsibility of setting medicaid reimbursement rates for residential health care facilities, including the type operated by the debtor prior to commencement of its Chapter 11 case. The Department, in its administrative review of the rates, consolidated two audit appeals by the debtor regarding cost disallowances and downward revisions of rates received by the debtor prior to filing its bankruptcy petition. In addition, the Department filed a proof of claim in the case for alleged medicaid overpayments to the debtor.[134]

The court found that the nursing home had been sold and that there were no longer any patients who needed protection. Consequently, the court indicated that the Department's actions constituted protection of a pecuniary interest in the debtor's property to the extent of its claim for medicaid overpayments[135] and held that the section 362(b)(4) exception to the automatic stay was unavailable.[136] The court did, however, grant the Department's application for relief from the stay under section 362(d)(1) of the Code in order to complete the administrative proceedings regarding the audit appeals.[137] The court based its decision on the following factors: (1) the administrative proceeding would not adversely affect a potentially successful reorganization since the debtor was completely liquidating its properties; (2) the appeals hearings would not re-

129. *Id.* at 708-09.
130. *Id.* at 708.
131. *Id.*
132. 34 Bankr. 954 (Bankr. S.D.N.Y. 1983).
133. *Id.* at 957.
134. *Id.* at 956.
135. *Id.* at 957.
136. *Id.*
137. *Id.* at 958.

sult in removing any property from the estate without a court order; and (3) the progress of the case would not be hindered since the debtor had the benefit of the stay for several years.[138]

In contrast to *Saugus General Hospital*[139] and *King Memorial Hospital*,[140] the court in *Lawson Burich Associates v. Axelrod* (*In re Lawson Burich Associates*)[141] held that section 362(b)(4) validly excepted from the stay the New York State Health Department's state court action (1) to have the Commissioner of Health appointed an interim receiver of a residential health care facility; (2) to facilitate a turnover of funds to the Commission; and (3) to obtain an injunction against the debtor as operator of the facility.[142] The Department of Health initiated the state action after it concluded that the debtor, as temporary receiver, had failed to comply with certain provisions of a pre-petition agreement between the debtor, the facility, the State of New York, and the Department of Health.[143]

The court noted that, in contrast to *Saugus General Hospital*,[144] the state's action was not directly related to the hospital's financial difficulties.[145] The court rejected the debtor's assertion that the state improperly sought a pecuniary benefit and found that the proceeding would serve the public welfare by attempting to curb the debtor's alleged misappropriation of funds, which were vital to the operation of the facility.[146]

Thomassen v. Division of Medical Quality Assurance (*In re Thomassen*)[147] also dealt with the distinctions between a valid state action to further the public health and one which was improperly motivated by a desire to obtain a pecuniary advantage over creditors of the estate. In *Thomassen*, the State Board of Medical Quality Assurance began an administrative action to examine allegations against the debtor of professional misconduct, including gross negligence or incompetence and acts of dishonesty in financial dealings.[148] The court held that the Board's proceedings served a valid police and regulatory purpose, since the allegations involved malpractice and fraud in the handling of the patients'

138. *Id.* at 957-58.
139. 1 COLLIER BANKR. CAS. 2d 26 (Bankr. D. Mass. 1979).
140. 4 Bankr. 704 (Bankr. S.D. Fla. 1980).
141. 31 Bankr. 604 (Bankr. S.D.N.Y. 1983).
142. *Id.* at 613.
143. *Id.* at 605-07.
144. 1 COLLIER BANKR. CAS. 2d at 26.
145. *Lawson Burich*, 31 Bankr. at 611.
146. *Id.* at 612-13.
147. 15 Bankr. 907 (Bankr. 9th Cir. 1981).
148. *Id.*

and employees' funds, rather than simply the failure to make payments to the state or its citizens.[149] Accordingly, the administrative proceeding was excepted from the automatic stay under section 362(b)(4).[150]

Also, in *In re 30 Hill Top Street Corp.*,[151] the Massachusetts Department of Public Health sought dismissal of a bankruptcy case based on the debtor's failure to remedy certain operational deficiencies in a nursing home. The court, in reliance upon *Lawson Burich*,[152] found that the Department, under section 362(b)(4), could properly enforce its order against the debtor denying new patient admissions to the debtor's facility until the state law violations were remedied.[153] The court further determined that, due to lack of funds in the case, the trustee was unable to operate the nursing home in compliance with state law as required by 28 U.S.C. § 959 and that dismissal of the case was necessary in order to allow appointment of a state court receiver to assume control of the debtor's operations.[154]

A second field in which section 362(b)(4) has been applied in cases involving health and safety laws may generally be classified as liquor licensing. The leading pre-Code case in that area, *Colonial Tavern, Inc. v. Byrne (In re Colonial Tavern, Inc.)*,[155] dealt with whether a state agency administrative action to suspend a debtor's liquor license should be enjoined pursuant to the Bankruptcy Rule 11-44[156] stay or the court's in-

149. *Id.* at 909.

150. *Id.* at 910.

151. 42 Bankr. 517 (Bankr. D. Mass. 1984).

152. 31 Bankr. at 604.

153. *Hill Top*, 42 Bankr. at 522.

154. *Id.* at 521-22.

155. 420 F. Supp. 44 (D. Mass. 1976).

156. Bankruptcy Rule 11-44(a), the automatic stay provision in Chapter XI cases under the Bankruptcy Act of 1898, provided:

> A petition filed under Rule 11-6 or 11-7 shall operate as a stay of the commencement or the continuation of any court or other proceeding against the debtor, or the enforcement of any judgment against him, or of any act or the commencement or continuation of any court proceeding to enforce any lien against his property, or of any court proceeding, except a case pending under Chapter X of the Act, for the purpose of the rehabilitation of the debtor or the liquidation of his estate.

11 U.S.C. app. Rule 11-44 (repealed 1978). The court in *Colonial Tavern* noted:

> Rule 11-44 is the counterpart of § 314 of the Bankruptcy Act (11 U.S.C. § 714) in that it makes automatic the stays which the Bankruptcy Court is authorized to impose under § 314 on application of the debtor. The purpose and subject matter are the same: Basically, to protect the assets of the debtor from independent attack by creditors pending the course of the Chapter XI arrangement.

420 F. Supp. at 45 (citation omitted). Section 314 of the Bankruptcy Act provided:

> The Court may, in addition to the relief provided by section 29 of this title and elsewhere under this chapter, enjoin or stay until final decree the commencement or continuation of suits other than suits to enforce liens upon the property of a debtor, and may, upon

junctive powers. The Boston Licensing Board and the Massachusetts Alcohol Beverage Control Commission, after an adversary hearing, had ordered the suspension of the debtor's liquor license for violation of a midnight closing regulation. The debtor sought a preliminary injunction against enforcement of the suspension, but the bankruptcy court refused the request on the grounds that the court lacked jurisdiction to interfere with the comprehensive regulatory laws of a state.[157]

The majority of courts, however, have determined that state and local licensing agencies should be stayed from revoking a debtor's liquor license for violation of various regulations. Generally, the government's action has been characterized as improperly motivated by financial considerations, such as the debtor's failure to pay its taxes, rather than by the valid purpose of protecting the public.

For example, in *Industrial National Bank v. Miceli (In re Gencarelli)*,[158] the bankruptcy court held that a municipal government's attempted revocation of the debtor's liquor license for its failure to remain open for business the number of hours required by state law would be stayed.[159] The court stated that enforcement of such a statute, which deals with the absence of business activity, was not the type of regulatory action intended to be excepted from the automatic stay, since the public health or safety was not threatened.[160]

Also, several courts have held that a state's administrative action to revoke or condition a debtor's liquor license would be stayed as improperly motivated by a pecuniary purpose, rather than authorized by its police or regulatory power. For example, in *Aegean Fare, Inc. v. Licensing Board (In re Aegean Fare, Inc.)*,[161] a city licensing board did not renew the debtor's liquor and restaurant licenses due to its nonpayment of prepetition meals taxes to the Commonwealth.[162] The Board based its decision upon the debtor's failure to satisfy the provisions of a state statute which conditioned renewal of the licenses upon the licensee's certification

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notice and for cause shown, enjoin or stay until final decree any act or the commencement or continuation of any proceeding to enforce any lien upon the property of a debtor.

11 U.S.C. § 714 (repealed 1978).

157. *Colonial Tavern*, 420 F. Supp. at 46. "Nothing in the prior case law of § 314 or the available history of Rule 11-44 suggests that the Bankruptcy Act was ever intended by Congress to subvert the valid police power of the states in this manner." *Id.*

158. 14 Bankr. 751 (Bankr. D.R.I. 1981).

159. *Id.* at 753.

160. *Id.*

161. 35 Bankr. 923 (Bankr. D. Mass. 1983).

162. *Id.* at 924-25.

that it had complied with the Commonwealth's tax laws.[163] The Board contended that its licensing actions were initiated pursuant to a valid regulatory purpose and that it did not seek to collect taxes by revoking the license.[164] The court rejected the Board's argument and found that although the Board's purpose was not to frustrate the priorities provisions of the Bankruptcy Code, the effect of the enforcement measure was to obtain a pecuniary advantage for the state over other creditors.[165] Accordingly, the court held that the provisions violated the supremacy clause and that the Board was subject to the automatic stay.[166]

Also, *In re Mason*[167] considered whether the State of Tennessee should be enjoined from attempting to revoke a debtor's liquor license. The state contended that it should be permitted to proceed with an administrative hearing to determine if the license should be revoked because the debtor's name appeared on the tax delinquency rolls three times during a calendar year in contravention of state law.[168]

The state asserted that the administrative proceeding was not based on a pecuniary purpose[169] and that it was not seeking to enforce a prepetition debt, as the debtor owed no money to the state on the date the bankruptcy petition was filed. The court agreed that the administrative action was a valid exercise of the state's police or regulatory power and thus was not subject to the automatic stay. It further stated that the action should nevertheless be conditionally stayed under section 105(a) of the Code,[170] because the liquor license was a substantial asset of the estate and the state's revocation action would constitute a "threat to the estate's assets."[171] The court adopted a balancing approach in making that determination, by stating that the loss of the license would diminish the value of the estate to the detriment of creditors, that the costs of prolonged litigation in the administrative proceedings would frustrate the debtor's plan of reorganization, and that the continuance of the debtor's

163. *Id.* at 925.
164. *Id.* at 926.
165. *Id.* at 927-28.
166. *Id.* at 928; *see also In re* Farmers Markets, Inc., 36 Bankr. 829, 832 (Bankr. E.D. Cal. 1984) (California State Board of Equalization and the Department of Alcoholic Beverage Control were stayed from restricting the transfer of the debtor's liquor licenses to obtain the payment of delinquent pre-petition taxes); Pizza of Hawaii, Inc. v. Department of Taxation (*In re* Pizza of Hawaii, Inc.), 12 Bankr. 796, 799 (Bankr. D. Hawaii 1981) (City Liquor Commission was stayed from conditioning its renewal of the debtor's liquor license upon receipt of a state tax clearance).
167. 18 Bankr. 817 (Bankr. W.D. Tenn. 1982).
168. *Id.* at 819-20.
169. *Id.* at 820.
170. *Id.* at 822.
171. *Id.* at 824.

business would not pose a threat to the health or safety of Tennessee residents.[172]

C. *Labor*

Governmental proceedings to enforce various labor laws against debtors have typically been viewed as falling within the section 362(b)(4) exception to the automatic stay, perhaps because the nature of relief sought is often directed at enjoining unfair labor practices. In those instances when the government action seeks compensation from the debtor, however, courts generally have determined that the proceeding is subject to the stay.

A leading pre-Code case, *NLRB v. Jonas* (*In re Bel Air Chateau Hospital*),[173] considered whether NLRB proceedings against the debtor to correct alleged violations of the National Labor Relations Act would be subject to the stay provisions of the Bankruptcy Act.[174] The NLRB sought to enforce its pre-petition order against the debtor for its refusal to bargain with a certified bargaining representative of its employees. In a consolidated case, the NLRB also proceeded against a debtor with unfair labor practice charges for wrongful discharge of several employees. The United States Court of Appeals for the Ninth Circuit, however, vacated the stays issued by lower courts against the NLRB[175] and stated that regulatory proceedings such as those initiated by the NLRB should not be subject either to the automatic stay of Bankruptcy Rule 11-44[176] or to a discretionary stay pursuant to section 314.[177]

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172. *Id.* at 822-24. The court conditioned its stay upon, among other things, the timely payment of the debtor's tax obligations to the state. *Id.* at 824. *But see In re* Arnage, Inc., 33 Bankr. 663, 665 (Bankr. E.D. Mich. 1983) (state liquor control commission was not stayed from cancelling the debtor's liquor license for failure of the trustee to file with the commission the proper request for an extension of the license).

173. 611 F.2d 1248 (9th Cir. 1979).

174. *Id.* at 1249.

175. *Id.* at 1251.

176. *Id.* The court followed Nathanson v. NLRB, 344 U.S. 25 (1977), in which the Supreme Court held that the NLRB, rather than a bankruptcy forum, was entitled to liquidate the amount of a back pay award owed by the bankruptcy debtor to its employees under an NLRB order. The court, summarizing *Nathanson*, stated: "[W]here the matter has been entrusted by Congress to an administrative agency, the bankruptcy court should normally stay its hand pending an administrative decision because Congress has entrusted to the agency the authority to determine appropriate remedies." *Bel Air Chateau*, 611 F.2d at 1250.

177. 611 F.2d at 1251. The court also stated:

> This result appears harmonious with the new bankruptcy law that recently became effective. Under 11 U.S.C. § 362(a)(1), the filing of a petition will normally operate as a stay of judicial or administrative proceedings. Section 362(b)(4), however, provides that the filing of a petition does not automatically stay an action by a governmental unit to enforce the government's police or regulatory power. Instead, stays will be granted only if

In *NLRB v. Evans Plumbing Co.*,[178] the NLRB sought to enforce its decision ordering a debtor to reinstate with back pay two employees who were discriminatorily discharged. The United States Court of Appeals for the Fifth Circuit, finding some support for its decision in dicta in *Bel Air Chateau*[179] and *In re Shippers Interstate Service*,[180] decided under the old Bankruptcy Act, held that the NLRB proceeding against the debtor fell within the section 362(b)(4) exception because the purpose of the action, to enforce certain employer-employee rights, constituted an exercise of police or regulatory power.[181]

In *Marshall v. Tauscher (In re Tauscher)*,[182] the court determined that administrative proceedings brought by the Secretary of Labor for alleged violations of the Fair Labor Standards Act would be excepted from the automatic stay to the extent that they fixed penalties and provided for the entry of a money judgment.[183] Enforcement of a money judgment, though, would be subject to the automatic stay.[184] Similarly, in *D.M. Barber, Inc. v. Valverde (In re D.M. Barber, Inc.)*,[185] the court recognized that the "compliance" stage of NLRB proceedings, which fixes the amount of debtor's liability for committing an unfair labor practice, is incident to the exercise of its regulatory power and within the section 362(b)(4) exception.[186] As in *Tauscher*, the court noted that en-

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a party shows the necessity for a stay. Section 362 thus makes explicit the principles of the old bankruptcy law: stays of regulatory proceedings should not be automatic but are appropriate when it is likely that the court proceedings will threaten the estate's assets.

Id. Similarly, in *In re* Shippers Interstate Serv., 618 F.2d 9 (7th Cir. 1980), the court held that the NLRB could proceed with an unfair labor practice case against a Chapter XI debtor where the estate's assets were not threatened and the company was being reorganized rather than liquidated. *Shippers Interstate*, 618 F.2d at 13; *accord* NLRB v. Brada Miller Freight Systems (*In re* Brada Miller Freight Systems), 16 Bankr. 1002 (Bankr. N.D. Ala. 1981); *see also* Rath Packing Co. v. United Food & Commercial Workers Int'l Union (*In re* Rath Packing Co.), 38 Bankr. 552 (Bankr. N.D. Iowa 1984) (alleged litigation expense and discouragement to potential buyers or investors did not pose a sufficient "threat" to the estate's assets to justify § 105(a) relief); GHR Energy Corp. v. NLRB (*In re* GHR Energy Corp.), 33 Bankr. 449, 450-51 (Bankr. D. Mass. 1983) (the court rejected the debtor's contention that an NLRB proceeding against the debtor regarding alleged wrongful discharge of employees in violation of the National Labor Relations Act would place a "cloud" on the title of the debtor's refinery sufficient to pose a threat to the debtor's estate).

178. 639 F.2d 291, 293 n.2 (5th Cir. 1981).

179. 611 F.2d at 1248.

180. 618 F.2d at 9.

181. *Evans*, 639 F.2d at 293; *accord* Donovan v. Timbers of Woodstock Restaurant, 19 Bankr. 629, 630 (Bankr. N.D. Ill. 1981).

182. 7 Bankr. 918 (Bankr. E.D. Wis. 1981).

183. *Id.* at 920.

184. *Id.*

185. 13 Bankr. 962 (Bankr. N.D. Tex. 1981).

186. *Id.* at 963; *see also* Donovan v. TMC Indus., 20 Bankr. 997, 1006 (Bankr. N.D. Ga. 1982) (the Secretary of Labor could properly maintain an injunctive action to prevent the debtor from shipping tainted goods in violation of the Fair Labor Standards Act).

forcement of a money judgment against the debtor would not be excepted from the automatic stay.[187] Both decisions reflect a proper application of section 362(b)(4) by permitting government actions to proceed when public welfare issues are at stake, while curbing actions aimed at obtaining a financial advantage over other creditors of a debtor's estate.

A mixed result with regard to the applicability of section 362(b)(4) occurred in *In re Howell*,[188] in which the Department of Labor sought a determination that, pursuant to the Federal Employees' Compensation Act (FECA), the Department had exclusive jurisdiction to determine disability, amount of payment, overpayment, rate of recoupment, and any subsequent redetermination of disability of the debtor.[189] The debtor had received disability payments from the Department pursuant to FECA, but a determination of overpayment was made and a specified amount withheld by the Department from the debtor's monthly disability benefits to recover the overpayments. The bankruptcy court recognized that determinations of the debtor's disability by the Department would not be stayed in the absence of creditor action.[190] On the other hand, the court stated that it had jurisdiction as to any claims by the Department against the debtor, and, therefore, the Department had no authority to withhold amounts from the debtor's benefits merely to recapture the overpayments.[191]

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187. *Tauscher*, 13 Bankr. at 963-64.

188. 4 Bankr. 102 (Bankr. M.D. Tenn. 1980).

189. *Id.* at 104.

190. *Id.* A proceeding involving unfair labor practice allegations may or may not be stayed, then, depending upon the nature of the relief sought. For example, in *In re* Powell, 27 Bankr. 146 (Bankr. W.D. Mo. 1983), the court explained such distinctions as follows:

> An unfair labor practice proceeding has two purposes. One is to enforce the national labor policy established by law. The other is to grant relief to particular parties who may have suffered damage by reason of violation of the law. Remedies are both prospective, such as the posting of notices or agreements as to future conduct, and retroactive, such as the awarding of back pay. Vindication of the policies of the Act may require remedies of both kinds.
>
> Prospective remedies, usually not pecuniary, may be dealt with in reorganization. Retroactive remedies, usually pecuniary, create a different problem. Such a remedy represents a claim which must be dealt with by the bankruptcy court which may or may not allow it.

In re Powell, 27 Bankr. at 147.

191. *Howell*, 4 Bankr. at 109. *But see* Donovan v. Quinta Contractors (*In re* Quinta Contractors), 34 Bankr. 129 (Bankr. M.D. Pa. 1983) (Secretary of Labor was not stayed from instituting administrative proceedings to establish the extent of the debtor's liability under the Davis-Bacon Act to withhold amounts payable to the debtor under certain government contracts, and from paying the sums directly to the debtor's employees for back wages). Also, in Donovan v. LaPorta (*In re* LaPorta), 26 Bankr. 687 (Bankr. N.D. Ill. 1982), the bankruptcy court reopened a Chapter 7 case after discharge of the debtor in order to allow the Secretary of Labor to proceed with an administrative hearing involving alleged violations by the debtor of the Service Contract Act and to determine the rightful ownership of funds withheld by the Secretary but due to the debtor under certain gov-

Ohio v. Mansfield Tire & Rubber Co. (In re Mansfield Tire & Rubber Co.)[192] involved an appeal by the Industrial Commission of Ohio, Bureau of Workers' Compensation from a bankruptcy court order. The order had determined that although the state's workers' compensation laws were a valid exercise of its police power, the Commission's actions in adjudicating workers' compensation claims did not amount to an enforcement of the police or regulatory powers of the state and therefore were not excepted from the automatic stay.[193] The court of appeals reversed and vacated the automatic stay with respect to the Commission's administration of workers' compensation claims,[194] finding no distinction between the enactment of the workers' compensation laws as a proper exercise of the state's police or regulatory power and the administration of claims arising under those laws.[195] Further, the court noted that the administrative actions of the Commission gave it no preferential treatment over creditors of the debtor and did not interfere with the property of the debtor's estate.[196]

In *Herr v. Maine (In re Herr)*,[197] the debtor challenged administrative proceedings held by the Maine Bureau of Employment Security, in which the Bureau established that the debtor had fraudulently received an overpayment of unemployment benefits. The Bureau also fixed the amount of overpayment and disqualified the debtor from receiving benefits for a six-month period.[198] The court, although not distinguishing the holding in *Mansfield Tire*,[199] stated that not every proceeding before the Maine Bureau would constitute an enforcement of police power within the meaning of section 362(b)(4).[200] Since this proceeding involved allegations of fraud, however, the court held that it fell clearly within the intent of that exception.[201] The problem with the *Mansfield Tire* ap-

ernment contracts. The court held that enforcement of the Service Contract Act, which provides for minimum wages and benefits for employees of government contractors, was not an attempt to protect a pecuniary interest in the debtor's property, but served a valid public interest of protecting employees' rights. *In re* LaPorta, 26 Bankr. at 691. Furthermore, since the proceeding was a Chapter 7 liquidation case with a "no asset" determination, its effect on the debtor's estate was speculative and would probably not result in diminution of the estate for distribution to creditors. *Id.* at 692.

192. 660 F.2d 1108 (6th Cir. 1981), *cert. denied*, 454 U.S. 1102 (1982).

193. *Id.* at 1113.

194. *Id.* at 1115.

195. *Id.* at 1113.

196. *Id.*

197. 28 Bankr. 465 (Bankr. D. Me. 1983).

198. *Id.* at 466.

199. 660 F.2d at 1108.

200. *Herr*, 28 Bankr. at 467.

201. *Id.* at 469.

proach is that a legislative pronouncement that a statute advances the public welfare simply cuts too wide a swath. Certain state laws are designed only to protect state financial interests. Thus, potentially competing Code considerations, such as aiding the orderly administration of the estate or giving debtors a temporary shield from creditor interference, are ignored. Accordingly, the analysis presented in *Herr* is more sensible and accurate because it considers the purpose and effect of the enforcement of state laws against debtors.[202]

In *Theobald Industries v. Local 786, International Chemical Workers Union (In re Theobald Industries)*,[203] a union brought NLRB administrative proceedings against the debtor to determine the validity of unfair labor practice charges involving vacation and severance pay, clothing allowances, and interest. The court held that the unfair labor practice proceedings were regulatory in nature, but that they were primarily related to the protection of a pecuniary interest in the debtor's estate and therefore were subject to the automatic stay.[204] Similarly, in *Continental Airlines v. National Mediation Board (In re Continental Airlines)*,[205] the court held that administrative hearings by the National Mediation Board on a union's application to become certified as representative of certain employees of the debtor would be subject to the automatic stay.[206] The court found that the potential election regarding certification did not constitute an "urgent" need for the exercise of police power.[207]

A different application of the stay in the context of administrative proceedings was involved in *In re Mazama Timber Products*.[208] In *Mazama*, the Oregon Department of Human Resources sought relief from the automatic stay in order to continue its proceedings to determine whether the debtor was liable for a deficiency in unemployment tax payments. The court did not address whether the proceedings were a valid exercise of a governmental unit's police or regulatory power, but instead found that "cause" existed under section 362(d)(1) of the Code to modify the stay.[209] This would allow the Department to proceed with a determination of the deficiency amount, while staying any collection remedies

202. *Id.* at 466.
203. 16 Bankr. 537 (Bankr. D.N.J. 1981).
204. *Id.* at 539.
205. 40 Bankr. 299 (Bankr. S.D. Tex. 1984).
206. *Id.* at 306.
207. *Id.* at 305.
208. 34 Bankr. 556 (Bankr. D. Or. 1983).
209. *Id.* at 557.

against the debtor.[210] The court referred to the appropriate state court forum any issues regarding the validity of the assessment, but retained its jurisdiction to determine the allowability and dischargeability of claims against the debtor.[211]

D. *Financial Integrity*

A number of cases which have addressed the applicability of the automatic stay to proceedings brought by governmental units may generally be categorized as dealing with the financial integrity of the debtor. The apparent conflict presented is whether the government's action has the primary purpose of advancing consumer protection or other valid police or regulatory interests or whether it is merely an attempt to obtain an unfair financial benefit for the government. Since the subject matter of these cases often directly involves control over or interests in the debtor's estate, virtually all of the decisions have resolved the issue by finding that the automatic stay applies and that the governmental unit's proceeding does not fall within the section 362(b)(4) exception.

The leading case dealing with the financial integrity of the debtor is *Missouri v. United States Bankruptcy Court*.[212] In that case, the debtors, who operated public grain elevators in Missouri and Arkansas, author-

210. *Id.*

211. *Id.* at 557-58.

212. 647 F.2d 768 (8th Cir. 1981), *cert. denied*, 454 U.S. 1162 (1982); *see also In re* Rath Packing Co., 35 Bankr. 615, 622 (Bankr. N.D. Iowa 1983) (Iowa State Insurance Commission revocation of debtor's self-insurance exemption from state workers' compensation requirements based upon debtor's insolvency violated automatic stay); Hill v. Farmers Home Admin. (*In re* Hill), 19 Bankr. 375, 379 (Bankr. N.D. Tex. 1982) (Farmers Home Administration declared in contempt for attempting to setoff Agricultural Stabilization and Conservation Service funds to which Chapter 11 debtor might be entitled against debt owed to FmHA); Muzio v. Sampson (*In re* Sampson), 17 Bankr. 528, 531 (Bankr. D. Conn. 1982) (state was stayed from post-petition enforcement of its financial responsibility statute against debtor involved in accident); Sachs v. Ryan (*In re* Ryan), 15 Bankr. 514, 519 (Bankr. D. Md. 1981) (state was stayed from pursuing forfeiture proceedings against certain funds of the debtor, as such proceedings under state law were neither a criminal action nor constituted an action by a governmental unit seeking enforcement of police oı regulatory powers); Heckler Land Dev. Corp. v. Township of Montgomery (*In re* Heckler Land Dev. Corp.), 15 Bankr. 856, 858 (Bankr. E.D. Pa. 1981) (township action in state court to obtain funds from escrow account established by debtor to serve as completion guarantee of land development project held subject to automatic stay); Campbell v. Gerace, 13 Bankr. 575, 576 (Bankr. S.D. Ohio 1981) (actions of Attorney General in taking judgment, perfecting a putative lien, and threatening legal action for debtor's nonpayment of state income tax violated automatic stay such that the court awarded actual damages to debtors and continued civil contempt proceedings against the state); *In re* Adana Mortgage Bankers, Inc., 12 Bankr. 989, 998 (Bankr. N.D. Ga. 1980) (Government National Mortgage Association post-petition declaration of default and termination of debtor's status as an issuer under certain mortgage servicing agreements held subject to automatic stay), *vacated*, 687 F.2d 344 (11th Cir. 1982); Gibbs v. Housing Auth. (*In re* Gibbs), 9 Bankr. 758, 763 (Bankr. D. Conn. 1981) (public housing authority was not exercising a police or regulatory power when it sought to evict a tenant pursuant to a state court judgment for possession based on nonpayment of rent).

ized the Missouri Department of Agriculture to operate and liquidate insolvent grain warehouses in accordance with Missouri law several days prior to filing petitions in bankruptcy. The Department filed receivership petitions for the grain warehouses in state court, and the receiver was appointed shortly after the bankruptcy filing, with orders to operate or liquidate the inventory to protect the interests of persons storing grain in the facilities.[213] The bankruptcy court appointed a trustee, who subsequently filed a request to sell the grain free and clear of all liens.[214] In response to the trustee's petition, Missouri authorities obtained a state court temporary restraining order against the trustee and a directive that the Department take possession of the grain warehouses.[215]

The State of Missouri sought a writ of prohibition in the United States Court of Appeals for the Eighth Circuit and appealed from a district court order[216] holding that the bankruptcy court possessed exclusive jurisdiction over the debtors' estate and that the state action was not excepted from application of the automatic stay. The Eighth Circuit affirmed the district court's holding and denied the petition for writ of prohibition.[217]

With respect to the jurisdiction of the bankruptcy court, the Eighth Circuit found that the debtors' possession of and small ownership interest in the grain constituted a sufficient legal or equitable interest within the broad scope of section 541 of the Code to trigger preliminary jurisdiction over the property in bankruptcy court.[218] The court limited that holding, though, by emphasizing that the bankruptcy court must administer the debtors' interests in accordance with the ownership rights of holders of documents of title under applicable state law.[219]

Furthermore, the court rejected the state's contention that the enforcement of its grain laws constituted a valid exercise of its police or regulatory power excepted by section 362(b)(4) from the automatic stay.[220] The court concluded that Missouri's grain laws were regulatory in nature, but primarily functioned to protect a pecuniary interest in the debtors' property rather than public safety and health.[221] Alternatively,

213. *Missouri*, 647 F.2d at 771.
214. *Id.* at 772.
215. *Id.* at 772-73.
216. *In re* Missouri, 7 Bankr. 974 (Bankr. E.D. Ark. 1980).
217. *Missouri*, 647 F.2d at 773-74.
218. *Id.* at 774.
219. *Id.* at 774-75.
220. *Id.* at 776.
221. *Id.* The court stated:

the court stated that even if the state liquidation proceedings were within the section 362(b)(4) exception, the bankruptcy court's jurisdiction over administration of the debtors' estate would preempt the state laws.[222]

Also, in *Joe DeLisi Fruit Co. v. Minnesota (In re Joe DeLisi Fruit Co.)*,[223] the debtor, a dealer in wholesale produce, sought to enjoin the Minnesota Department of Agriculture from proceeding to determine claims by its suppliers against a letter of credit. The debtor, as part of its state licensing requirements, had obtained the letter of credit to ensure the performance of its statutory duties. The failure to pay suppliers when due constituted a breach of state statute and permitted claims against the letter of credit. The suppliers notified the state Commissioner of Agriculture that the debtor had defaulted in the payments, and the Commissioner issued a notice setting forth the procedure to persons to make a claim against the letter of credit.[224]

The court did not address the Department's contention that since the letter of credit was not property of the debtor the stay did not apply to its proceeding.[225] The court stated instead that the scope of the stay did more than prevent claims against assets of the debtor; it also gave the debtor the opportunity to organize its affairs without having to defend itself from creditors.[226] The court also held that the Department's actions were not excepted from the stay by virtue of section 362(b)(4), because the proceeding dealt primarily with the financial affairs of the debtor rather than the protection of public health, safety, or welfare.[227]

> In light of the legislative history and court decisions under the earlier bankruptcy act, we believe that the term "police or regulatory power" refers to the enforcement of state laws affecting health, welfare, morals, and safety, but not regulatory laws that directly conflict with the control of the *res* or property by the bankruptcy court.

Id.

222. *Id.*

223. 11 Bankr. 694 (Bankr. D. Minn. 1981).

224. *Id.* at 695.

225. *Id.* at 695-96. The court stated, "[t]he action commenced by the Commissioner is an administrative, quasi-judicial proceeding. . . . Evidence is present [sic], witnesses are examined and cross-examined. A hearing officer presides and awards judgment to the prevailing party. Ultimately, the Minnesota Supreme Court may review the matter on appeal. The action is against the debtor." *Id.* at 696.

226. *Id.*

227. *Id.* at 696-97. The court stated:

> The action by the Commissioner is not to restrain or punish any violation of the statute. It is not to determine licensing requirements or to collect damages from the debtor for violation. The State of Minnesota is not the complainant. The action is by and for the benefit of the creditors of the debtor. Any recovery will be to their benefit. The statute which proscribes this procedure was enacted to provide "financial protection" for a certain class of individuals favored by the state. It was not done to protect the public health, welfare and safety.

Id. (citation omitted).

In *In re Jacobsmeyer*,[228] the debtors, who filed for reorganization of their retail liquor store under Chapter 13 of the Code, filed an application for an order to show cause why the Missouri Department of Liquor Control and several wholesale liquor distributors should not be held in contempt for violation of the automatic stay. The debtor alleged that the wholesalers refused to fill purchase orders even on a C.O.D. basis because they were concerned about violating state laws. The purpose of the state law involved was to prevent financial control of the retailer by a wholesaler through extraordinary extensions of credit.[229]

The bankruptcy court acknowledged that the state purpose of keeping certain liquor activities financially separated reached conduct affecting the public welfare and only indirectly protected pecuniary interests.[230] The court further found, however, that the unintended result of the statute's enforcement was to require debtors to pay certain unsecured pre-petition debts in full, resulting in preferential or discriminatory treatment of some creditors in the Chapter 13 plan.[231] As a result, the court enjoined the state Director of Liquor Control from enforcing the credit regulations against the wholesalers to the extent that enforcement required the debtors to pay pre-petition debts to obtain goods to operate.[232]

Only a handful of cases dealing with the financial integrity of the debtor have found a governmental unit's proceeding to be excepted from the stay under section 362(b)(4). For example, in *Fintel v. Oregon* (*In re Fintel*),[233] the State of Oregon sought enforcement of Builders Board orders finding the debtor liable to claimants under a surety bond obtained by the debtor. The debtor had posted the bond pursuant to a state consumer protection statute designed to protect the public from financially irresponsible builders. The bankruptcy court permitted enforcement of the Board's order over objections by the debtor that it needed the bond for future licensing and that it might suffer loss of Builder's registration as an indirect consequence of losing the bond.[234] The court premised the holding on its finding that the state law was a valid exercise of police or regulatory power and that neither the individual claimants nor the Board interfered with the bankruptcy proceeding or reduced the debtor's

228. 13 Bankr. 298 (Bankr. W.D. Mo. 1981).
229. *Id.* at 300.
230. *Id.* at 301.
231. *Id.* at 302.
232. *Id.*
233. 10 Bankr. 50 (Bankr. D. Or. 1981).
234. *Id.* at 52.

estate.[235]

Also, in *Swan v. Dervos (In re Dervos)*,[236] the bankruptcy court determined that a proceeding against the debtor for restitution to certain individuals under the Illinois Wage Payment and Collection Act constituted a valid exercise of police or regulatory power.[237] The court based its holding on the view that the state sought to protect the interests of its citizens against fraud and to prevent the repetition of future fraudulent behavior.[238]

Finally, in *Cannon v. Missouri (In re Cannon)*,[239] the State of Missouri sought a permanent injunction and restitution to individuals who suffered harm because of alleged violations by the debtor of statutes pertaining to merchandising practices. The court held that, to the extent that the state proceeding involved restitution or a money judgment, it would be automatically stayed.[240] In ruling on the injunction, the court decided not to consider the action under section 362(b)(4), but found that sufficient "cause" existed under section 362(d) of the Code to justify relief from the stay.[241] The court recognized the following reasons in finding that cause existed: (1) the state court and bankruptcy court trials were set for the same time; (2) the lack of precedent under the state statutes regarding merchandising practices left it unclear whether a judgment against the debtor would include a fixed dollar amount; (3) the issues were ripe for adjudication in state court; (4) repetitive litigation would be avoided; (5) determination of the merits would be expedited; and (6) the administration of the liquidating Chapter 7 case would not be adversely affected by the state court proceeding.[242]

E. *Securities Regulation*

Only a few cases have addressed the application of the automatic stay to proceedings involving securities regulations. In the government

235. *Id.*

236. 37 Bankr. 731 (Bankr. N.D. Ill. 1984).

237. *Id.* at 734.

238. *Id.* In FTC v. R.A. Walker & Assoc., 37 Bankr. 608 (D.D.C. 1983), the district court declined to modify its temporary restraining order imposing a freeze on the debtor's assets and enjoining persons having control of records, accounts, and assets of the debtor from disposing of them. The court stated that the jurisdiction of the district court to freeze the debtor's assets would not be impaired by the filing of the petition in bankruptcy, since the debtor was accused of fraudulent conduct, no liquidation of the estate was contemplated, and no trustee had yet been appointed to prevent dissipation of the assets. 37 Bankr. at 610-12.

239. 30 Bankr. 565 (Bankr. E.D. Mo. 1983).

240. *Id.* at 567.

241. *Id.*; *see supra* note 18 for text of section 362(d).

242. *Cannon*, 30 Bankr. at 567-68.

proceedings which have alleged violations of the anti-fraud provisions of the state and federal securities laws, the section 362(b)(4) exception has been clearly available. Conversely, when the government action has been directed at obtaining some financial compensation from the debtor, courts have been more inclined to find that the proceeding runs afoul of the pecuniary purpose test.

In *SEC v. First Financial Group*,[243] the Securities and Exchange Commission brought a civil enforcement action for injunctive relief and for appointment of a temporary receiver of the defendant's assets, alleging violation of certain anti-fraud provisions of the federal securities laws. The defendants had sold to the public a securities package comprised of federally guaranteed student loans and a repurchase agreement, but the defendants failed to deposit the securities for safekeeping and then defaulted in their repurchase obligations.[244]

The district court, prior to the filing of any petition in bankruptcy, preliminarily enjoined the defendants from offering or selling the securities in violation of the federal securities laws and from disposing of certain records and assets of their business.[245] Subsequently, after an involuntary petition in bankruptcy had been filed against the defendant corporation, the district court ordered the appointment of a temporary receiver for the corporation.[246]

The debtor contended that the appointment of a temporary receiver constituted an "act to obtain possession of property of the estate" within the meaning of section 362(a)(3) of the Code and, therefore, was not excepted from the automatic stay by section 362(b)(4).[247] The United States Court of Appeals for the Fifth Circuit recognized that there was no stated exception to section 362(a)(3), but held that the appointment of a temporary receiver was a necessary form of ancillary relief in an SEC civil enforcement action for injunctive relief.[248]

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243. 645 F.2d 429 (5th Cir. 1981). In a later decision involving matters in the same case, the United States Court of Appeals for the Fifth Circuit affirmed a default judgment against First Financial officers for their failure to comply with discovery requests. 659 F.2d 660 (5th Cir. 1981).

244. 645 F.2d at 431-32.

245. *Id.* at 432.

246. *Id.*

247. *Id.* at 437-38.

248. *Id.* at 438. The court stated:

> The district court's exercise of its equity power in this respect is particularly necessary in instances in which the corporate defendant, through its management, has defrauded members of the investing public; in such cases, it is likely that, in the absence of the appointment of a receiver to maintain the status quo, the corporate assets will be subject to diversion and waste to the detriment of those who were induced to invest in the corporate scheme and for whose benefit, in some measure, the SEC injunctive action was brought.

On the other hand, in *Coben v. Lebrun (In re Golden Plan, Inc.)*,[249] the court held that the action of the California Franchise Tax Board in suspending the corporate powers of the debtor for its failure to pay certain state taxes was subject to the automatic stay.[250] As a result of the Board's suspension, a third party had filed articles of incorporation using the debtor's corporate name. The court stated that since the Board's action had violated the stay, its suspension was void, and the third party's filing of incorporation documents had no effect.[251] Further, the court stated that a permanent injunction would properly issue under section 105(a) against the third party, preventing appropriation of the debtor's corporate name.[252]

III. CONCLUSION

Section 362(b)(4) provides a significant exception to the automatic stay for the commencement or continuation of proceedings brought by governmental units against debtors to enforce police or regulatory powers. An inherent conflict exists in determining whether the policy considerations which favor shielding a debtor from creditor interference should give way to countervailing policy concerns for protection of the public from a debtor conducting its business in a manner detrimental to the public health, welfare, and safety.

A proper evaluation of the applicability of section 362(b)(4) requires a several-stage analysis, beginning with determining whether the action is brought by a governmental unit. If it is not, then section 362(b)(4) is unavailable, although relief from the stay may still be sought if "cause"

Id. (footnote omitted). The court further noted that the phrase "an act to obtain possession" was not intended to include the judicial appointment of a receiver pursuant to a governmental unit's enforcement of its police or regulatory powers (and the transfer of possession of the violator's property to the receiver in order that he may perform his duty to maintain the status quo). Rather, the automatic stay applies to prevent dismemberment of the estate and insure its orderly distribution, . . . in order to eliminate the impetus for a race of diligence by fast-acting creditors.

Id. at 439 (citations omitted); *accord* Commodity Futures Trading Comm'n v. Co Petro Mktg. Group, 700 F.2d 1279, 1280 (9th Cir. 1983); Commodity Futures Trading Comm'n v. Incomco, Inc., 649 F.2d 128, 133 (2d Cir. 1981).

249. 37 Bankr. 167 (Bankr. E.D. Cal. 1984).

250. *Id.* at 170.

251. *Id.*

252. *Id.* at 170-71. The court stated that the standard with respect to issuance of a permanent injunction was that the defendant's actions will cause irreparable harm and that no adequate remedy at law exists. In this case, the use of the debtor's corporate name would interfere with administration of the estate because it would cause confusion among third parties dealing with the trustee. Furthermore, no adequate legal remedy was available because if the trustee was forced continually to bring actions prohibiting the appropriation of the name, it would be prevented from properly administering the estate. *Id.*

exists under section 362(d). The next test is whether the governmental action is brought to effectuate some public policy rather than simply to adjudicate private rights. Courts have often neglected this inquiry, but it is necessary in order to consider thoroughly whether the exception to the stay should be available.

The third and most critical inquiry must be to determine whether the purpose of the government's action is to enforce laws affecting the public health and welfare, as contrasted to those proceedings which may be characterized as an attempt to obtain a financial advantage over other creditors or unreasonably to interfere with property of the debtor's estate. This pecuniary purpose test is the cornerstone with respect to whether a particular governmental action satisfies section 362(b)(4), principally because most proceedings have some impact on the debtor's financial resources. It is imperative, then, for a court to consider the motivating purpose behind a government's proceeding, rather than merely to rely upon a legislative pronouncement that a given law was enacted to protect the public welfare. In order to aid that analysis, courts should consider the underlying policy considerations relevant to the subject matter involved and the type of relief sought. Thus, an injunctive action to prevent a violation of an environmental law would normally merit an exception to the stay, while an action for damages for a debtor's nonpayment of taxes should be stayed. The urgency with which the government's action is instituted may be one factor in the pecuniary purpose test, but is an unreasonable additional test for otherwise validly commenced proceedings.

Finally, if a particular governmental proceeding satisfies the pecuniary purpose and public policy tests, a court may issue a stay under its discretionary authority pursuant to Code section 105(a) if it appears that the government's action presents a sufficient threat to the assets of the debtor's estate. This authority generally has been and should continue to be applied sparingly, when the balance of interests favors extraordinary relief for the debtor.