

Automatic Stay: Why Can't I Just Keep Collecting on Pre-Bankruptcy Claims?

What Is the Automatic Stay?

When an individual or a company files for bankruptcy, a statutory injunction called the “automatic stay” immediately comes into effect. The automatic stay is intended to protect the debtor and the property of its bankruptcy estate from litigation and other creditor action, while the bankruptcy case plays out. Toward that end, the automatic stay is extremely broad, and bars all entities, including lenders, creditors, vendors, and contract counterparties, from:

- Commencing or continuing any action or proceeding against the debtor that could have been started before the bankruptcy, or to recover a claim against the debtor that arose before the bankruptcy;
- Enforcing any judgment against the debtor;
- Taking any act to obtain possession or exercise control over any property of the debtor’s bankruptcy estate;
- Taking any act to create, perfect, or enforce a lien against property of the debtor’s bankruptcy estate;
- Taking any act to create, perfect, or enforce a lien on property of the debtor to the extent it secures a claim that arose before the bankruptcy.
- Taking any act to collect, assess, or recover a claim against the debtor that arose before the bankruptcy; or
- Effectuating certain setoffs of debts.

Key Issues

As with most issues under the Bankruptcy Code, there are important nuances to the automatic stay, as well as implications of the automatic stay that may not be immediately apparent. A few examples of that include:

- A creditor may be able to perfect certain liens that relate back in time, such as mechanics liens, notwithstanding the automatic stay;
- The exercise of some seemingly clear contractual rights by the nondebtor party to a pre-bankruptcy contract or lease (such as unilaterally terminating the contract or lease in accordance with its terms) may violate the automatic stay;
- There are a variety of statutory exceptions to the automatic stay, including certain police, regulatory, and other governmental action; and

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- Notwithstanding the reference above to a prohibition on acts taken “to recover a claim that arose before the bankruptcy,” stay violations also may occur even with respect to actions taken to recover a claim that arose after the commencement of bankruptcy if that action is not properly handled.

The bankruptcy court has considerable discretion to impose potentially costly sanctions for violations of the automatic stay, particularly when those violations are intentional or occur after the creditor knows of the bankruptcy.

Takeaway

Before taking or continuing any action against a debtor or its property, creditors should seek competent legal advice. The Bankruptcy Code affords well-counseled creditors a means to protect their rights and claims in the bankruptcy case without violating the automatic stay. However, to avoid the risk of an inadvertent stay violation, those strategies should be evaluated with counsel before action is taken, not after.

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