

**Bankruptcy's Automatic Stay: Litigation and Insurance Policies
An Introduction**

Bankruptcy, while governed by statute, is an equitable process in which the court attempts to maximize value from a bankrupt company or individual for the benefit of the debtor's creditors and the reorganized debtor (if any exists). Central to the bankruptcy process is the Automatic Stay codified at 11 USC § 362. Section 362 provides that, upon the filing of a bankruptcy petition, all litigation, lien enforcement, and other actions, judicial or non-judicial, in which a third party attempts to enforce or collect pre-petition claims are prohibited. The prohibition is effective automatically upon the filing of a bankruptcy petition. Actions taken in violation of the stay are void or voidable, even where there is no actual notice of the bankruptcy. More seriously, violation of the stay is also punishable as contempt of court. In instances where a party has received either oral or written notice of the bankruptcy case, the court may sanction a party for violating the automatic stay. In this way the stay maintains the status quo and permits an organized reorganization or liquidation of the bankruptcy estate.

Litigation, Offensive Actions of the Debtor, and Declaratory Judgment Actions

Section 362(a)(1) extends the automatic stay to a broad range of litigation against the debtor that was or could have been commenced prior to the commencement of the bankruptcy case. Thus the stay halts previously commenced judicial proceedings and prohibits new actions from being filed against the debtor. This includes even the issuance of process against the debtor. By section 362(a)(2) the enforcement of pre-petition judgments is also stayed. Notably, the stay of litigation does not protect non-debtor parties, so actions may continue against co-defendants of the debtor. Also, the debtor-in-possession may be allowed by the court to continue litigation in which it is a Plaintiff because "the automatic stay does not apply to actions by the debtor in which the debtor is in an offensive posture." *In re U.S. Abatement Corp.*, 157 B.R. 278, 279 (E.D. La. 1993). This extends to counterclaims the debtor may have filed in pending litigation. *Id.*

The stay is broad enough to bar all judicial proceedings against the debtor including declaratory judgment actions. *In re Johns-Manville Corp.*, 31 B.R. 965, 968-969 (S.D.N.Y. 1983). In order for an insurer to pursue a declaratory judgment action against an insured, relief from the automatic stay should first be sought. *See e.g. Peerless Ins. Co. v. Rivera*, 208 B.R.313 (D.R.I. 1997).

Insurance Policies

Pre-petition insurance policies are generally considered property of the bankruptcy estate and are protected by the automatic stay under section 362(a)(3). *In re Davis*, 730 F.2d 176, 184 (5th Cir. 1984), citing *Johns-Mansville Corp v. The Asbestos Litigation Group (In re Johns-Mansville)*, 40 B.R. 219 (S.D.N.Y. 1984)(finding that the "weight of authority" supports the position that insurance is "property of the estate" as defined by 11 USC § 541(a)(1)). Therefore, the automatic stay precludes the cancellation

of an insurance policy or any direct action against a debtor's insurer to recover proceeds of the debtor's insurance policy. As with litigation against the debtor, relief from the stay should be sought before a debtor's insurance policy is cancelled. Insurers should not view this relief as automatic, particularly in reorganization bankruptcies. *In re Cahokia Downs, Inc.*, 5 B.R. 529 (Bankr. S.D. Ill. 1980)(refusing to terminate the automatic stay to allow cancellation of fire insurance policy when policy was necessary to protect the property of the estate for reorganization). However, if the policy was entered into with the debtor post-petition, it is likely exempt from the automatic stay. *In re Plexus Enter.*, 289 B.R. 778 (Bankr. M.D. Fla. 2002).

Lifting the Stay

11 USC § 362(d) provides that the court "shall" grant relief from the stay by terminating, annulling, modifying or conditioning the stay, "for cause, including the lack of adequate protection of an interest in property." The court "shall" also grant relief from the stay if the debtor has no equity in the property and the property is not necessary for an effective reorganization. Under this section the court is allowed to fashion the relief required based on the circumstances affecting a party in interest. Cause is most commonly found to be the lack of adequate protection under section 362(d)(1), but is not limited to this definition.

In order to obtain relief from the stay, a party in interest must file a motion under bankruptcy Rule 9014. The motion must be served on the official committees of creditors, or if no committees have been formed, on all scheduled creditors. Section 362(e) requires that the stay be automatically vacated 30 days after relief is requested, unless the court, after notice and a hearing orders the stay continued pending, or as the result of, a final hearing. Therefore, filing a motion for relief from stay places a party in interest on a "fast track" to a determination of whether or not the stay should be kept in place or modified. Local rules of the particular bankruptcy court will often include additional procedural requirements for a motion for relief from the stay. Local rules should always be referenced thoroughly when filing for relief from the automatic stay.