

# **THE IMPACT OF BANKRUPTCY STAYS ON STATE TRIAL COURTS**

*- FINAL REPORT -*

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# Impact of Bankruptcy Stays on State Trial Courts

## I. Introduction

The Justice Management Institute, through a grant from the State Justice Institute, has conducted a preliminary study examining the impact of bankruptcy stays on civil and family law litigation in state trial courts. Specifically, the study focused on the impact of 11 U.S.C. § 362, the Federal statute that provides for an automatic stay of state court proceedings involving a debtor with a pending petition in the United States Bankruptcy Court.

The objective of the study was to improve the courts' response to cases with bankruptcy stays. Fair and timely resolution of cases is a core objective of courts, forming one of the bases for public trust and confidence in the courts. An automatic stay of the proceedings in a state court case triggered by a bankruptcy petition has the direct result of slowing the pace of litigation in the state court case. Although the stay serves to protect the debtor's estate for orderly distribution to creditors or for successful reorganization, the delay caused by the stay may contribute to losses suffered by those people and businesses in the state court case whose claims are placed "on hold" by the automatic stay. For these reasons, it is important to examine the ways in which state trial courts handle cases that have been stayed because of pending bankruptcy proceedings and to look at how this ultimately affects the proceedings and outcomes of these cases. It is also useful to identify how changes in the bankruptcy procedures and practices might minimize the negative impacts in state court cases. Identifying the impacts will allow the courts to avoid unnecessary activity, and more effectively manage cases in which a stay arises.

Several preliminary observations can be made from the information gathered as part of this project. Bankruptcy stays appear to be relatively infrequent, occurring in less than 1%, to as many as 6%, of cases in the jurisdictions studied. There does not appear to be any particular pattern as to when the bankruptcy stay arises in a state court case; it can arise at any time. The duration of the stay is typically about 200 days. There is little difference in the age of cases at resolution involving a stay, as compared to cases where there was no stay. It also appears that in very few cases in which a stay arose does the case continue to resolution as to other defendants. Further, in only a very few cases is the stay lifted and the case resolved as to the defendant who had filed the bankruptcy petition.

What state courts do in response to a stay varies widely. Most simply "close" the case, at least statistically. Some have mechanisms for monitoring the case to reactivate it when the stay is lifted. The difficulties experienced in gathering quantitative data suggests there are internal inconsistencies within each court as to how the presence of a stay is noted in the case management system, and what is done in response to information suggesting there is a stay. This preliminary study suggests several possible responses by state courts to standardize the way cases with stays are handled, and reduce the negative impact. There are also some possible changes in the bankruptcy procedures, primarily having to do with notice, that would aid the state courts, without unduly burdening the bankruptcy petitioner, the bankruptcy court or the state court.

In order to place the study in context it is useful to understand what a bankruptcy stay is and what it does. The basics of the bankruptcy stay law are as follows. The Federal Bankruptcy Code provides for an automatic stay of the commencement or continuation of any judicial action or proceeding against a person or entity that is the subject of a bankruptcy petition (11 USC § 362(a)). The automatic stay is considered one of the fundamental protections in the bankruptcy law for debtors and creditors. It provides the debtor a breathing spell from creditors, and it preserves assets for creditors. The stay of state court proceedings is automatic upon filing of the petition in bankruptcy court; the debtor need not file or serve any document on any court in order for the stay to take effect<sup>1</sup>. The automatic stay only relates to actions against the debtor,<sup>2</sup> that is, where the debtor is the defendant or respondent. It does not stay the action as against parties<sup>3</sup> other than the debtor in a case, nor does it stay an action where the debtor is a plaintiff or petitioner. There are several specific exceptions to the stay: criminal cases, establishing and modifying child or spousal support, and establishing paternity (11 USC § 362(b)). The stay is terminated automatically when the bankruptcy case is closed<sup>4</sup> (11 USC § 362(c)), but in the normal consumer case it is replaced by a permanent injunction.<sup>5</sup> When the bankruptcy case is closed, no notice is required to be provided to either the other parties in a stayed action, or to the state court where there are actions stayed. A party in an action that has been stayed can apply to the bankruptcy court to lift the stay and allow the state court action to proceed against the debtor defendant (11 USC § 362(d)).

There are three basic types of bankruptcy proceedings, liquidations (Chapter 7), reorganizations (Chapters 11, 12), and debt adjustment for individuals (Chapter 13). Chapter 7 proceedings involve the liquidation of most of the debtor's assets with the proceeds distributed among the creditors and the discharge of the debts. Under reorganizations the debtor's assets are not liquidated, rather, debts are paid by the debtor according to a plan established in the bankruptcy proceeding. Liquidation proceedings are generally completed much more quickly than reorganization or Chapter 13 proceedings because the proceedings have become routinized and because they rarely involve the operations of a business or negotiations with creditors. In liquidation cases there are often no assets, so the bankruptcy case can proceed fairly quickly.

The debtor/petitioner in a bankruptcy case must list all debts to be addressed in the case. The Statement of Financial Affairs to be completed by the debtor also requires listing of all pending state court cases where the defendant is a party.<sup>6</sup>

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<sup>1</sup> Although the debtor is not required to notify the state court, it is generally the debtor who informs the state court of the stay when the state court attempts to take some action in the case.

<sup>2</sup> There is also a stay for co-debtors in Chapter 13 cases (11 USC § 1301).

<sup>3</sup> In certain types of cases, particularly complex cases, there may be a stay as to other parties, particularly if the debtor is a key party in the action.

<sup>4</sup> Under 11 USC § 362(c) the stay continues until the case is closed, dismissed, or a discharge is granted or denied.

<sup>5</sup> See 11 USC § 524(a).

<sup>6</sup> United State Bankruptcy Court, Form 7, Statement of Financial Affairs, question 4.

## II. Project Background and Methodology

The project began by examining case processing in two large urban jurisdictions, the Los Angeles Superior Court in California and the Circuit Court of Prince George's County in Maryland (adjacent to Washington, D.C.). These courts were chosen either because of the high number of bankruptcy filings in the associated federal jurisdiction<sup>7</sup> or because of the availability of data. Both of these courts are general jurisdiction state trial courts. During discussions with the staff in the Los Angeles Superior Court they suggested also contacting the Los Angeles Municipal Court, a limited jurisdiction state trial court, so this court was examined as well.<sup>8</sup> Information was also gathered from one other state trial court, the Licking Court of Common Pleas in Newark, Ohio, from which information about cases involving bankruptcy stays was readily available.

Project staff met with officials from the Los Angeles and Prince George's County courts and gathered information on the handling of cases with bankruptcy stays, and the ways, if any, in which stays disrupt the litigation process and affect the rights and interests of other litigants. Drawing on interviews of judges, lawyers, and court staff members the inquiry sought to identify:

- ⌚ Differences between the courts, both in procedures and other responses on being informed of bankruptcy stays;
- ⌚ Problems, and perceived problems, in the handling of cases in which bankruptcy stays arise;
- ⌚ Practices that appear to be effective in handling cases involving bankruptcy stays; and
- ⌚ Possible ways to improve the handling of bankruptcy stays by: a) the state trial court in which proceedings are stayed, or b) the bankruptcy court.

Quantitative information was also sought in each court from which to estimate the frequency with which bankruptcy stays arose in state court proceedings, the length of the stays, and the specific types of cases in which proceedings are stayed. The goal was to collect case specific data from each jurisdiction for cases that were resolved between 1996 and 1998 in which there had been a bankruptcy stay. The specific data elements requested included:

- ⌚ Date the case was filed,
- ⌚ Date the case was disposed,
- ⌚ Case type,
- ⌚ Date the suggestion of bankruptcy was noted, and
- ⌚ Date the stay was lifted.

Because this type of case specific information is kept differently in each jurisdiction, not all of the information was always available from each court. However, enough data was collected

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<sup>7</sup> Although the number of bankruptcy filings was high in Los Angeles, this was not the jurisdiction with the highest rate of bankruptcy filings, calculated on a per population basis.

<sup>8</sup> Subsequent to the initially gathering of information in the Los Angeles Courts, the two courts were merged into one unified court pursuant to a Constitutional amendment.

from the three courts to provide preliminary information about the impact of the bankruptcy stay on cases in state trial courts.

Using the available data from the courts in Los Angeles, Licking County, and Prince George's County, the analysis reported here focuses on seven main questions about the scope of the bankruptcy stay occurrence in each of the participating courts. The questions were as follows:

- ⌚ What proportion of the total caseload in each court is affected by bankruptcy stays?
- ⌚ In what types of cases are bankruptcy stays most likely to be filed?
- ⌚ When do bankruptcy stays tend to arise during the life of a case?
- ⌚ When there is a bankruptcy stay, for how long is it in effect?
- ⌚ When there has been a bankruptcy stay, how long does it take to resolve the state court case?
- ⌚ How do the time periods to resolve cases in which bankruptcy stays existed compare with the time periods to resolve similar cases in which no stay was existed?
- ⌚ What is the impact of bankruptcy stays on the outcomes of cases?

Although the nature of the data sought was limited, the identification of the cases in a court's caseload with bankruptcy stays proved to be very difficult. Once the cases were identified, the analysis of the data was more protracted than anticipated. There needed to be several iterations, as one analysis exposed subtleties that required further analysis of the information. Because of the difficulties obtaining data, and the small number of courts studied, the analysis summarized below should be viewed as preliminary, as opposed to definitive. The analysis does, nonetheless, provide relevant information about the scope of the problem and where to look for possible responses.

After a preliminary analysis of the quantitative data and court responses, a meeting was convened of an Advisory Committee to review and comment on the findings and recommendations. The membership of the Advisory Committee is provided in Appendix A. Following the Advisory Committee meeting further analysis was done of the quantitative data. Information was also added regarding the nature of bankruptcy proceedings and the responses of state courts. The report of findings and recommendations was then revised to include the additional analysis and the valuable suggestions and comments of the Advisory Committee members.

### III. Review of Quantitative Findings

Overall, in the courts studied, the suspension of a case because of a pending bankruptcy proceeding did not appear to be a frequent occurrence. Bankruptcy stays appear to be even less common in tort cases. There does not appear to be a pattern as to when, in the life of the state court case, a bankruptcy stay is brought to the attention of the state court. Cases in which there is a stay do not appear to take longer than other cases; although it appears many cases are essentially abandoned once the stay is filed. The duration of the stay appears to be about 200 days, which is consistent with the typical duration of a case in bankruptcy court.

Since each court handles stayed cases slightly differently, it is only possible to report on general trends for each jurisdiction on the research questions noted above. The analysis below is organized by the research questions listed above. A brief description of the case selection method in each court of the courts studied is provided in Appendix B.

#### A. Frequency of Bankruptcy Stays

The threshold question is the frequency of cases involving a bankruptcy stay, that is, what proportion of the caseload in each court is affected by bankruptcy stays. Because of the different methods of identifying cases with stays in each jurisdiction, only estimates of the frequency can be calculated.

##### Prince George's County Circuit Court

Data were collected from the set of civil cases (not including family law cases) filed between 1990 and 1998 and resolved between 1996 and 1998. A total of 155 cases were identified as statistically closed or suspended due to bankruptcy mentions during this time period. Unfortunately there is no information as to the total number of civil cases that were filed between 1990 and 1998 and resolved between 1996 and 1998, so a precise frequency statistic cannot be calculated. However, there are approximately 25,000-30,000 cases resolved each fiscal year, suggesting the frequency of cases with stays is less than 1%.

##### Los Angeles Superior Court

In the Los Angeles Superior Court, data was collected for civil cases (not including family law) resolved between 1996 and 1998. A total of 6,579 cases were removed from the court's control because of pending bankruptcy proceedings during the three-year period. The total number of resolutions for this time period was 164,809 cases, suggesting a frequency of cases with bankruptcy stays of approximately 4%.

##### Los Angeles Municipal Court

Data provided by the Los Angeles Municipal Court identified a total number of 2,441 cases where a stay due to bankruptcy was noted between 1996 and 1998. There was not much difference in the number of bankruptcy stays between 1996 and 1997 (671 and 739, respectively), but there was about a 40% increase in the number of bankruptcies filed from 1997

to 1998 (739 and 1,031, respectively). The number of cases resolved during the same period totaled about 320,000 cases, suggesting a frequency of less than 1%.

Licking County Common Pleas Court

Data provided by the Common Pleas Court suggests a higher bankruptcy rate in a more suburban county. During the 1999-2001 calendar period there were 98 cases in which a bankruptcy stay was filed, and a total of 1,534 civil filings. This suggests a bankruptcy stay frequency of 6.4%.

Observations

Notwithstanding the difficulty in obtaining strictly comparable information to determine the frequency of stays, it appears that cases involving bankruptcy stays are relatively infrequent. One possible explanation of the low frequency may be that the courts do not regularly or consistently record the existence of the stay, so the identification of all cases with stays is not possible without examining the file in every case. The higher frequency in Licking County suggests at least two possibilities: stays may be more frequent in urban and suburban courts, or the court may have practices that more consistently identify cases that are subject to a stay. This ought to be explored in any future studies. Note that the economy was quite strong in the time frame from which cases were drawn, and this may also have affected the frequency.

B. Types of Cases With Bankruptcy Stays

The second question concerned the mix of cases with bankruptcy stays, as compared to the mix of the total caseload. The interest is in the types of cases in which bankruptcy stays are most likely to occur. Data to answer this question was available in only one of the courts studied. Problems encountered with the data extraction process precluded the analysis of case mix in the Prince George’s County Circuit Court and Los Angeles Municipal Court.

Los Angeles Superior Court

Table 1 compares the case mix of cases with bankruptcy stays to the information reported to the state on overall caseload mix.

**TABLE 1**  
LOS ANGELES SUPERIOR COURT

COMPARISON OF CASE MIX OF CASES WITH A STAY TO ALL CASES

Type of Case	Percentage of Cases:	
	Bankruptcy Stay Case resolutions	FY 95-96 to FY 97-98 Resolutions
Personal Injury – Automobile	8.2%	29%
Personal Injury – Other	22.4%	22%
Other Civil Complaint	69.5%	49%

The information in this table suggests bankruptcy stays are far less common in personal injury cases, and more common in “other civil complaint” cases, where contract, property, and business cases are counted.

Although detailed case mix data was not reported for the overall caseload in Los Angeles Superior Court, the information provided on cases with a stay does include more detailed case types than are specified in the above table. Table 2 indicates the distribution of case types for those cases with bankruptcy stays.

**TABLE 2**  
LOS ANGELES SUPERIOR COURT

<u>Case Type</u>	<u>Percentage of all cases with a stay</u>
Personal Injury – Motor Vehicle	8.2%
Subtotal: Personal Injury – Motor Vehicle	8.2%
Personal Injury – Malpractice	1.8%
Personal injury – Other	6.1%
Personal Injury – Product Liability	1.1%
Personal Injury – Wrongful Death, Asbestos	13.3%
Subtotal: Personal Injury – Other	22.4%
Civil Complaint – asbestos – property damage	<0.1%
Civil Complaint – contract	28.6%
Civil Complaint - declaratory relief	3.3%
Civil Complaint – injunctive relief	1.6%
Civil Complaint – malpractice	1.9%
Civil Complaint – promissory note	6.8%
Civil Complaint – other real property rights	2.1%
Civil Complaint – unlawful detainer	1.4%
Civil Complaint (no further detailed provided)	23.8%
Subtotal: Other Civil Complaint	69.5%

Stays appear to be more common in cases with commercial type transactions, that is, contract and promissory notes, although a large percentage were in those cases where case type detail was not provided.

Observations

Not much can be said based on this limited information about which types of cases are more likely to involve bankruptcy stays. They appear to be more common in civil case categories other than personal injury cases. Further analysis is needed on this question. A companion question is what types of bankruptcy petitions (liquidation versus reorganization) are involved in which types of state cases.

### C. When Do Stays Arise in the Life of a Case

The information gathered permits an analysis of when the bankruptcy stay arises relative to the filing of the case, or the entry of judgment. However, the data was not detailed enough to allow determination of the stage of the case (e.g., pleading, discovery, or trial) when the bankruptcy stay became known.

#### Prince George's County Circuit Court

The cases from Prince George's County only included cases where the stay was noted prior to the judgment in the case. A review of when the bankruptcy stay is made known, relative to the start of the case, shows that in about 8% of the cases the bankruptcy stay becomes known within a month of the filing of the case. The stay becomes known within the first 180 days in 40%<sup>9</sup> of the cases, and it occurs within the first year in 70% of the cases.

The one pattern apparent from the data in Prince George's County Circuit Court is that once the bankruptcy stay becomes known, it is usually the last activity in the case. In 78% of the cases the last activity is the suggestion of bankruptcy stay. In another 8.5% of the cases there is activity for only another week, then activity ceases. In 8% of the cases there was activity for more than a month after the stay become known, and in 3% activity continued for more than a year before the case was resolved.

#### Los Angeles Superior Court

Where the stay arose before judgment, the stay was filed within the first month in 4.2% of the cases.<sup>10</sup> The stay was filed in less than 180 days in 34.4% of the cases. The stay was filed within the first year after filing in 64% of the cases. The stay arose after the judgment in about 6% of the cases.

#### Los Angeles Municipal Court

In cases where the stay occurred before the judgment, the stay was filed within the first month in 14% of the cases. The stay was filed in the first 180 days in 66% of the cases, and within the first year in 84% of the cases. The stay occurred after judgment in slightly over 52% of the cases.

#### Observations

A preliminary analysis suggests that there is no particular pattern as to when bankruptcy stays arise in civil cases, relative to the commencement of the case. In particular it does not appear that stays occur just prior to the start of trial, a commonly held belief. Comparing the two Los Angeles courts suggests that stays seem to occur primarily before judgment in general jurisdiction courts, but more commonly after disposition in limited jurisdiction cases.

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<sup>9</sup> The percentages are cumulative.

<sup>10</sup> The figure is for cases less than five years old.

D. Pace of Litigation Where There Was a Bankruptcy Stay

The question here had several aspects. Where a bankruptcy stay exists, how long does it take to resolve the case? How much does it delay the proceedings, that is, how do the time periods required to resolve cases in which a bankruptcy stay has been filed compare with the time required to resolve similar cases in which no stay was filed? Finally, where there is a stay, how long does the stay last?

Prince George's County Circuit Court

In Prince George's County Circuit Court cases with bankruptcy stays appear to be resolved more quickly than cases in general. Because the set of cases with stays was a multi-year sample, information on the pace of litigation was not available for the comparable set of all cases. However, data was available on the pace of litigation for individual years for all cases resolved during 1998, 1999 and 2000. Table 3 presents the data in as comparable a manner as is possible.

**TABLE 3**  
PRINCE GEORGE'S COUNTY CIRCUIT COURT  
AVERAGE AGE FROM FILING TO DISPOSITION\*

<u>Time Frame</u>	<u>All Civil Cases</u>	<u>Civil cases with Bankruptcy Stay</u>
FY 1998	248 days	
FY 1999	232 days	
FY 2000	238 days	
Filed in 1990-1998 and resolved in 1996-1998 -----		225 days

\* Averages exclude cases over 721 days old.

As noted in the footnote, the figures in the table do not include cases over 721 days old.<sup>11</sup> In the set of cases with a bankruptcy stay 19% of the cases were over 721 days old at resolution, a significant percentage. However, 63% of the cases were resolved in one year or less. Comparable numbers for the overall caseload were not readily available.

From the Prince George's Court data it was also possible to measure the duration of the stay due to bankruptcy, although the number of such cases (5 of 155) was very small. The average duration was 197 days, with the range from 110 days to 324 days, and a median of 174 days.

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<sup>11</sup> This is the way it is reported in the annual statistical report.

## Los Angeles Superior Court

Table 4 compares the age at resolution of all cases with information on cases in which there was a bankruptcy stay in Los Angeles Superior Court.

**TABLE 4**  
**LOS ANGELES SUPERIOR COURT**  
**AGE OF CASES AT RESOLUTION**

<u>Resolved in:</u>	All cases resolved in <u>FY 97-98</u>	Cases with <u>Bankruptcy Stay</u>
Less than 12 months:	50%	52%
Less than 18 months:	74%	68%
Less than 2 years:	86%	75%

The average age at resolution of cases in which there was a bankruptcy stay mentioned was 518 days. From this data it appears that some cases with stays are resolved faster than typical cases. However, there is also a greater percentage that take longer to be resolved.

The Los Angeles Superior Court also provided information on when the case was removed from the court's control and then when it was returned to the court's control, that is when the stay was lifted and the case could proceed. For those cases in which the stay occurred prior to disposition of the case, the average duration of the stay was 197 days and the median was 156 days. The range of the stay was from 0<sup>12</sup> to 1,159 days, although the stay lasted less than a year in 84% of the cases. For those cases where the stay arose after the judgment, the average length of stay was 187 days, with a median of 141 days. The range of the post-judgment stay was from 0 days to 754 days, with the stay lasting less than a year in 82% of the cases.

## Los Angeles Municipal Court

Although the data are not strictly comparable, Table 5 suggests the age of resolved cases is not that different for cases with stays and those without a stay.

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<sup>12</sup> A time of 0 days probably arises from the bankruptcy court dismissing the petition the day after it was filed.

**TABLE 5**  
**LOS ANGELES MUNICIPAL COURT**

AGE OF CASE AT RESOLUTION

	General Civil Cases Resolved in FY 97-98	Cases with a Stay*
Less than 1 year	62%	67%
Less than 18 months	78%	78%
Less than 2 years	85%	87%

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\* Includes unlawful detainer cases not included in the  
General Civil case statistics

As was found in Los Angeles Superior Court, more cases with stays are ended sooner. However, in this court there is not a larger group of older cases with a stay.

Observations

The results here are somewhat counter-intuitive. Cases where there is a bankruptcy stay appear to take less time than cases without stays. If there is a stay, a case should take longer to resolve, reflecting the time needed to conclude the bankruptcy. The explanation appears to be that where there is a stay, the case essentially ends. Plaintiffs and other parties apparently abandon the claim on the assumption that if the defendant filed for bankruptcy, there will be no assets from which to pay any settlement or judgment, so why pursue the litigation. The data from Prince George's County confirms this; the suggestion of bankruptcy stay is usually the last activity in the case.

The data on the length of stays was quite similar across courts. The figure, approximately 190-200 days, is also consistent with the expectation that a no-asset Chapter 7 filing takes approximately 180 days from filing to conclusion.

#### E. What Happens In Cases With Bankruptcy Stays

Some information was available in the Prince George's court data about what happens in cases in which a bankruptcy stay arises. In a majority of the cases, notice of the bankruptcy stay effectively ended the case. In approximately 4% of the cases there was an indication that the stay was lifted, and the case proceeded to resolution after the stay was lifted. In another 2% of the cases the case proceeded to trial as to defendants not covered by the stay. The balance of the cases "ended" with the filing of the suggestion of bankruptcy.

Similar data was not gathered in the Los Angeles courts, although there was information about the percentage of cases still pending at the time the data was collected. In Los Angeles Superior Court approximately 2% of the cases in the data set had not been resolved at the time of the data collection. In Los Angeles Municipal Court approximately 29% of the cases were still pending at the time the data was extracted.

#### **IV. What Do State Courts Do In Response To Bankruptcy Stays**

Information was also gathered from the courts studied about how the court responded to the presence of a bankruptcy stay in a case. The objective was to identify both impacts of stays and current practices to see what might be done to lessen any negative impacts of stays. The interview protocol for gathering the information is included in Appendix C.

The typical response of state trial courts to a bankruptcy stay was simply stated by the Chief Judge in an urban state trial court as follows: “Close the case.” The judge noted that there were plenty of other cases pending before the court which could be acted upon rather than worrying about the stayed case. The cases with the bankruptcy stay went into a “suspended” caseload and were not monitored. Not all courts expressed this sentiment, but the data suggests this is the typical response, by the parties as well as the court. A summary of each of the court’s responses is provided below.

##### Prince George’s County Circuit Court

In this jurisdiction once a mention of bankruptcy is made in a civil case, the case is deemed inactive and is closed *statistically*. This means that for case statistics reporting purposes the case is not considered active, so any statistics on pace of litigation are not skewed by these suspended cases. The case will not be re-opened until an attorney files a request to lift the stay. Although the State of Maryland does have a rule in place designed to alert the court after a certain amount of time has passed with no activity in a case,<sup>13</sup> this will not catch a case, such as a bankruptcy case, that is statistically closed. The court noted there is no existing mechanism for automatic notification of when a bankruptcy proceeding is concluded, nor is there any notice of any events which would abrogate the stay. The court has not established a process for monitoring these cases to see if the stay is still in effect, or if the case can be re-opened. It is up to an attorney or party to monitor whether the case can proceed and to initiate some action to re-open the case.

##### Los Angeles County Superior Court

During the initial stages of the project, JMI staff interviewed several Los Angeles County Superior Court staff and gathered information regarding the occurrences and handling of civil cases where the defendant has filed for bankruptcy. In this jurisdiction when bankruptcy is suggested in a civil case, the case is placed in a ‘suspended’ status, but is not considered closed. There is a specific case code in the case management system that is to be used when a case is stayed due to bankruptcy. However, uniform use of the code only began recently. Family cases are handled differently. When there is a bankruptcy mention in a family law case, the case is bifurcated so that the issues exempt from the stay can be dealt with.

##### Los Angeles Municipal Court

JMI staff met with a senior manager of what at the time was the Civil Division of the Los Angeles Municipal Court about cases with bankruptcy stays. The Los Angeles District was the

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<sup>13</sup> Maryland Rule 2507.

largest of the 24 Municipal Court Districts in Los Angeles County. According to the manager, the LA Municipal Court averaged about 100 suggestions of bankruptcy a week. When a suggestion of bankruptcy is filed, a case becomes inactive and is removed from the pending list.

The court had become plagued with a large number of post-disposition suggestions of bankruptcy. These were mainly in unlawful detainer cases where the judgment was eviction. In these types of cases, if a defendant claims bankruptcy after the detainer case has been concluded, the eviction will be slowed down while the bankruptcy claim is pursued. The manager noted a problem of the filing of false bankruptcy claims in these cases. Because some people learned that their eviction case would be stayed if they suggested bankruptcy, many were claiming to have filed bankruptcy when, in fact, no bankruptcy petition had been filed. In 1997, 205 unlawful detainer cases were stayed due to bankruptcy post-disposition; in 1998, the number rose to 367. When the court became aware of this problem it began to require that the defendant provide the court with proof of bankruptcy filing before staying the case.<sup>14</sup> This has been successful in decreasing the number of suggestions of bankruptcy the court experienced, and eliminated the large amount of court resources used in investigating these claims.

#### Licking County Common Pleas Court

The court reported that they generally found out about a bankruptcy filing from the debtor who filed the bankruptcy petition, although generally not at the time the petition is filed. The filing and resulting stay were generally brought to the court's attention at or before the scheduled pretrial conference. The court required proof of the bankruptcy filing before acting on it. When the stay was verified, the court placed the case on an inactive status for statistical purposes. The case did not proceed as to the other parties. The court reported that other parties rarely seek relief from the stay. The court reactivated the case when the debtor filed a Motion to Reactivate and provided a copy of the discharge from the bankruptcy court.

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<sup>14</sup> Alternatively the Court could have checked with the bankruptcy court to see if there was a petition, including possible use of the PACER system, the automated case management information system used to provide information about federal court cases, which can be accessed remotely if you are a subscriber. However, given the volume of cases with alleged stays, checking every case would have placed a significant burden on the Municipal Court staff.

## V. Observations and Recommendations

### General Observations

Although each jurisdiction handles civil cases suspended due to a bankruptcy stay slightly differently, there does not seem to be an overwhelming problem caused by the appearance of the bankruptcy stays in civil cases. The Los Angeles Municipal Court by far had the most difficult issue to deal with, a noticeable number of false bankruptcy claims, and it seems as though they have dealt with it successfully. There are different problems in family law cases, particularly from post-judgment bankruptcies. Several alternative approaches, for the bankruptcy courts as well as for the state trial courts, are available to minimize the impacts of bankruptcy stays.

The state courts studied do not always have a clear policy, or consistent practice, for identifying the presence of a bankruptcy stay. Courts appear not to "code" cases with a stay in a way that reflects the legal implications of the stay, i.e., that the case is suspended, as opposed to being closed. It has also been reported that some state court clerk's offices return to the sender documents informing the state trial court of a bankruptcy stay. This may be due to any one of a number of reasons. For example, a clerk may not understand the significance of the documents, or may be returned because the bankruptcy lawyer has not made an appearance in the case, or is not licensed to practice in the state court. These types of responses are probably attributable to the low frequency of stays, staff turnover, and limited training about stays. It may also be due to the automatic character of the stay. For virtually all other actions in state trial courts one of the parties must overtly make a request for something to be done, or the court must issue an order for something to be done or to cease; actions do not occur 'automatically.' This suggests both the need to develop policies and practices to properly identify cases with stays, as well as the need for training of court and clerk of court staff regarding the policies and practices about what to do once a stay is suggested.

The low frequency of bankruptcy stays also has implications for state court judges. State court judges often rotate assignments, in some courts as often as annually. When they change assignments, they need to learn, or re-learn, what the best approach is for cases in which a stay arises. This is even more of a problem in family law cases where the impact of the stay is more complicated. This creates an on-going need for judicial education for judges changing assignments.<sup>15</sup> Established procedures, implemented by court or clerk of court staff using automated case management systems can also be an effective way to provide consistency across cases notwithstanding changes in judicial assignments as well as across cases.

Good case management practices would suggest that a court adopt a monitoring procedure for cases where a bankruptcy stay arises. The underlying principle is that a court has the responsibility to ensure cases move to a just resolution in a timely manner. One way to achieve this is for every case to have a next event scheduled so that no case becomes "lost" in the pending caseload. Applying these principles, if a state trial court becomes aware of a bankruptcy stay in a case, the court should calendar a hearing to review the status of the stay at

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<sup>15</sup> For example the American Bankruptcy Institute regularly provides continuing education to state trial judges regarding bankruptcy law.

some point in the future when the bankruptcy proceeding is likely to be completed (the data collected here suggests approximately 210 days later). While it might appear to be simpler to rely on the parties to notify the court of the conclusion of the bankruptcy case, the study suggests the parties cannot be relied upon to do this. As the objective of the status hearing would be to determine the status of the stay and the ability of the state court case to proceed, only the parties or their attorneys need participate; there is no need for the trustee or bankruptcy lawyer(s) to attend. The conference could be done by a conference call to minimize the cost of the proceeding. If it were scheduled sufficiently far out, there would generally be no more than one such status conference in a state court case. At the status hearing the case would either be re-activated, if the status of the bankruptcy stay has changed, or another status hearing would be set at a point in the future when the parties indicate the bankruptcy case would most likely be concluded.

This type of process is not in place in the courts studied, probably for a number of reasons. The low frequency of cases with stays suggests developing such a process may not be worthwhile. The sense that most cases in which a stay appears are thereupon abandoned also makes this effort seem less worthwhile, although the perception may be self-fulfilling. The likelihood that the stay will become a permanent injunction, abrogating substantive resolution of the state court case, probably reduces party interest in attending a status conference about the progress of the bankruptcy case. Finally, there may also be a sense, probably incorrect,<sup>16</sup> that even the scheduling of a status hearing violates the stay; that the state court does not have the authority to even calendar a status hearing in a case where a stay is applicable. However, the low frequency of occurrence is probably a good reason to establish a procedure for monitoring cases with bankruptcy stays. Having an established, written procedure makes it less likely that court staff will respond to mention of a stay in an ad hoc manner and helps when there is staff turnover. It will also improve the consistency with which cases are handled, providing a higher level of due process and equal protection.

An alternative to scheduling a status hearing would be to have the conclusion of the bankruptcy case trigger re-activation of the state court case. This could be accomplished a number of ways. The state court or plaintiffs in a case could regularly check the status of the bankruptcy case, for example through PACER. However, this would probably be a poor use of state court resources. The debtor/petitioner could be required to notify the state court at the conclusion of the bankruptcy case, but there is little incentive to do this since the debtor/petitioner is a defendant in the state court case. Another alternative is for the bankruptcy court to send notice of the closing of the bankruptcy case to the state court at the same time other parties are notified. This would require that the state trial court case be on the notice list in the bankruptcy court, at least for the disposition of the case. Since the Statement of Financial Affairs requires the debtor to list pending state court cases, including the case numbers, the information should be available to the bankruptcy court for sending a notice.

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<sup>16</sup> Although the stay provisions clearly apply to state courts, if the status conference is merely to determine the status of the bankruptcy case, and does not involve any activity related to the property that is subject to the bankruptcy proceeding, the conference would not appear to violate the stay provision.

## Family Law Cases

A different set of problems arises in family law cases. As noted in the introduction, there are exceptions to the stay, most notably, child support actions and actions to establish or modify alimony, maintenance or support. However, the presence of a bankruptcy petition can have significant impacts on the proceedings to distribute the property and allocate the debts of a marriage. If one or both spouses files a bankruptcy petition before the dissolution is filed, it can prevent issuance of temporary orders, such as for spousal support and attorneys fees, temporary injunctive orders, and orders regarding some enforcement proceedings, as well as disrupt the distribution of marital property.

Once there is a stay the negotiation and resolution of the property aspects of the dissolution can be distorted by the potential reallocation of marital debts and assets by the bankruptcy court. Although the bankruptcy trustee is not a party to the dissolution proceeding, the trustee's possible actions are critical to the resolution of the property division. This suggests that there be contact between the state court judge and the bankruptcy trustee in some cases to resolve common issues in a mutually supportive manner, notwithstanding the apparent significant financial disincentive on the part of the trustee to become involved. Often the financial status of the marriage is such that a bankruptcy is possible, if not likely, and the parties, especially if they are self-represented, are unaware of this, or do not adequately plan for it.

Post-dissolution bankruptcies are even more troublesome. The stay prevents enforcement of non-child support orders such as spousal support, attorney's fees, debt repayment and other property distribution.<sup>17</sup> Moreover, the "equitable distribution" of assets and debt in the dissolution judgment can essentially be undone in the bankruptcy, as the bankruptcy proceeding has different laws and objectives. Even though the former spouse may be a co-debtor, the spouse is generally not a creditor who has the opportunity to appear and participate in the bankruptcy. Reportedly, the debtor often does not even let a former spouse know of the bankruptcy proceeding until it is concluded. Under state law the final judgment in the dissolution action is final and the former spouse cannot return to the state court to revise the judgment to reflect the new circumstances established by the bankruptcy court. While the possibility of a bankruptcy can, to some extent, be provided for in the final judgment, often it is not adequately anticipated, if at all.

To some extent these potential problems can be anticipated and provided for in final judgments of dissolution or associated documents. This requires awareness by, and training of, family law lawyers and judges, as well as those who assist self-represented litigants. They must be made aware of the potential problems and know possible solutions, such as adding provisions regarding bankruptcy to final judgments, or otherwise establishing certain debts as non-dischargeable under certain circumstances.

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<sup>17</sup> The stay would not prevent enforcement of orders as to property that was not part of the estate in the bankruptcy proceeding. What is available for distribution from the estate of the debtor differs in liquidation and reorganization proceedings, so the impact of the stay is different for each type of case.

## Recommendations

1. State trial courts and their clerks of court should develop procedures to consistently identify and 'code' bankruptcy stays so as to be able to use case management systems to properly monitor, track and count them.
2. State trial courts should consider developing policies for how to respond to stays, including scheduling follow-up hearings to determine the status of the bankruptcy filing.
3. State trial courts should educate court and clerk of court employees about the impact of the bankruptcy stay, and the appropriate response to information about the filing of a bankruptcy petition or suggestion of a stay.
4. State court judges should continue to receive education about the impact of bankruptcy law and effective responses to the presence of bankruptcy stays.
5. Judicial and lawyer education providers should develop programs and provide education to state court judges hearing family law matters, family law lawyers, and staff in programs who assist unrepresented litigants in family law cases about how to anticipate impacts of bankruptcy filings on the distribution of assets and liabilities in dissolution decrees and orders.
6. Bankruptcy courts should authorize and train state court staff and clerk of court staff to access the PACER system to check the existence and status of bankruptcy cases.
7. Require the debtor/petitioner to serve notice of the filing of the bankruptcy petition on any former spouse whose has joint or shared liability for debts that are the subject of the bankruptcy petition. Alternatively, or in addition, require all debtor/petitioners to list all divorces, past or pending, in the "Statement of Financial Affairs" and inform the trustee of any temporary or final orders regarding marital assets and liabilities.
8. Bankruptcy courts should add the state trial court to the list of creditors and parties to whom notices are sent by the bankruptcy court or attorneys, at least as to the notice of discharge.
9. Establish a protocol encouraging informal contact between bankruptcy courts and state courts in their jurisdiction for gathering and exchanging information about individuals with cases in both courts, particularly in family law cases.

## Research Questions for Future Studies

As noted several times in this report there were complications in the collection of the data, or, in retrospect, insufficient detail was gathered, in order to more definitively answer the questions initially posed. Moreover, as the data was analyzed in an attempt to answer the initial questions, additional questions became apparent for which insufficient data was collected. If additional research is done on this subject, the following list of research questions should be considered in planning further data collection and analysis:

- a) In order to more accurately assess the frequency of individuals or entities who file bankruptcy petitions also being involved in state court actions, and the converse, examine whether the debtor/petitioners in a set of cases in bankruptcy court are parties to state court actions, and whether the defendants in a set of state court cases have filed bankruptcy petitions. The objective of the cross-reference is to allow a more comprehensive identification of the frequency and impact of stays, and proposed responses to them.
- b) Are there differences in the frequency of stays in urban, suburban and rural courts? Are there differences in the frequency of stays based on the condition of the economy?
- c) What types of cases have bankruptcy stays? Are they more common in certain categories of cases, such as business or commercial transactions, foreclosure, collections, or consumer debt/purchase cases? How common are they in family law cases?
- d) At what stage of a state court case does the bankruptcy stay usually arise, that is during the pleading phase, discovery phase, at point of trial, or post-judgment? Does it vary with type of case?
- e) When does the party filing bankruptcy typically inform the state trial court of the bankruptcy, relative to actual filing of the bankruptcy petition? Is the state court informed of the bankruptcy petition in a timely manner, or is the state court informed only when the state court attempts to take some action on the case?
- f) What typically happens in cases where a stay is present? Do cases where there has been a stay typically resolve in a different pattern from cases without stays? Are there differences in the pattern of disposition based on case type? Are most cases simply abandoned by plaintiffs when the defendant notes a stay, as appears from the data gathered here? What if there are defendants other than the debtor, how often does the case proceed against the other defendants? How often does the case continue once the bankruptcy case is terminated, and what happens?
- g) How long is the delay of the state court proceeding relative to the length of time to process the bankruptcy and relative to the conclusion of the bankruptcy case? Does this vary with case type, especially with family law cases?

- h) Does the debtor inform the state court of the lift of the stay when the case is ended in bankruptcy court, or does the debtor wait for the state court or one of the other parties to take action before acknowledging the lifting of the stay?
- i) Are there differences in the answers to the questions posed above based on whether the bankruptcy filing is a liquidation or reorganization proceeding?
- j) Are there differences in the answers to the questions posed above in family law proceedings? How do frequencies of bankruptcy and the impact of stays vary depending upon whether the bankruptcy occurs pre-filing, after filing but before judgment, or post-judgment?

## **APPENDIX A**

### **ADVISORY COMMITTEE MEMBERSHIP**

In alphabetical order:

Samuel Gerdano, Director, American Bankruptcy Institute, Alexandria, VA

Richard Hoffman, President, Justice Strategies, Washington, D.C.

Margaret Howard, Professor, American Bankruptcy Institute, Alexandria, VA

Richard L. Levine, Attorney at Law, Hill and Barlow, a Professional Corporation, Boston, MA

Janet M. Nesse, Attorney at Law, Stinson Morrison Hecker LLP and a Bankruptcy Trustee, Washington, D.C.

William Rule, Senior Economist, Bankruptcy Judges' Division, Administrative Office of the U.S. Courts, Washington, D.C.

Hon. Susan Snow, Retired Judge, Cook County Circuit Court, Illinois

## **APPENDIX B**

### **CASE SELECTION METHOD**

#### **Prince George's County Circuit Court, Maryland**

Data were collected from the Prince George's County Circuit Court for civil cases filed between 1990 and 1998 and disposed of between 1996 and 1998. This sample does not include family court cases, as they are contained in a completely separate database. A total of 155 cases were identified as statistically closed or suspended due to bankruptcy mentions during this time period. The set of cases includes only cases where the stay was filed before the case was resolved.

#### **Los Angeles Superior Court**

In the Los Angeles Superior Court, data was collected for cases in which a stay was noted and which were resolved between 1996 and 1998. A total of 6,580 cases were removed from the court's control because of pending bankruptcy proceedings during the three-year period. The set of cases identified does not include eminent domain, civil petition, small claims appeals cases, or family law cases.

#### **Los Angeles Municipal Court**

The set of cases selected were those suspended by a bankruptcy stay between 1996 and 1998, regardless of when the case was filed or resolved, or when the stay arose relative to the resolution of the case. A few cases had more than one stay.

#### **Licking Court of Common Pleas, Newark, Ohio**

Aggregate figures were requested from the Court on the total number of filings and number of cases in which there was a bankruptcy stay filed for each of the calendar years 1998, 1999 and 2000.

## APPENDIX C

### INTERVIEW PROTOCOL REGARDING STATE TRIAL COURT RESPONSE TO BANKRUPTCY STAYS

#### WHO TO INTERVIEW

Find the person in the court who knows how the court responds to notices of bankruptcy stays from a case management point of view. This could be either, or both of:

- ⌚ Case manager for the court; master calendar clerk; or
- ⌚ Judge who hears case management conferences.

#### WHAT TO ASK

- ⌚ How do you generally find out about the existence of a bankruptcy stay for a party in a case?
- ⌚ When, in the life of a case, does the court typically find out about a stay? During discovery? When trial is scheduled?
- ⌚ What does your court do when the existence of a stay becomes known?
- ⌚ Do you require "proof" of the bankruptcy filing? If so, of what type?
- ⌚ What impacts does the existence of a stay have on a case? For the debtor? For other parties in the case? Do parties seek relief from stays very often?
- ⌚ What would you say are the major abuses, if any, of the bankruptcy stay provision? What could be done to minimize the abuses?
- ⌚ Do you treat other parties differently from the party who has filed bankruptcy, i.e., try to move the case forward for them?
- ⌚ How and when does the court find out that a bankruptcy case has ended, and the state court action can be restarted?
- ⌚ If you could change anything about the bankruptcy stay process or provisions, what would you change?