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<b>KRS 243.630 (9) Unauthorized Transfer Of License While Pending Proceedings</b>	On or about (or before) _____, 20__, (date of sale), the licensee transferred an interest in his/her/its license while a proceeding was pending before the Alcoholic Beverage Control Board for suspension or revocation of said license, in violation of the above statute.
<b>KRS 243.630 (10) Unauthorized Transfer Of License When Owed Wholesaler</b>	On or about (or before) _____, 20__, (date of sale), the licensee transferred an interest in his/her/its license when the licensee owed a debt on inventory to a wholesaler responsible for the collection and payment of the tax imposed under KRS 243.884, in violation of the above statute.
<b>KRS 243.630 (11) Unauthorized Transfer Of License When Owed Revenue Cabinet.</b>	On or about (or before) _____, 20__, (date of sale), the licensee transferred an interest in his/her/its license when the licensee owed the Kentucky Revenue Cabinet for taxes, in violation of the above statute.
<b>KRS 243.640(2) Continuance of business by defunct licensee</b>	On or about _____, 20__, (date of dissolution), the licensee continued to operate business on the licensed premises after dissolution without prior approval of the state administrator, in violation of the above statute.
<b>KRS 243.660 Pledging of license as security</b>	On or about _____, 20__, (date of pledge), the licensee pledged or hypothecated its/his/her license(s) with the Department of Alcoholic Beverage Control, in violation of the above statute.
<b>KRS 243.670 (with KRS 243.500(3)) Pay Own License Fee</b>	On or about _____, 20__, (date when fee paid), a person other the licensee paid the licensee's application fee, in violation of the above statute.
<b>KRS 243.895 Post Pregnancy Warning Sign</b>	On or about _____, 20__, and for an undetermined period of time prior thereto, the licensee failed to post a sign on the licensed premises which warned that drinking alcoholic beverages prior to conception or during pregnancy can cause birth defects, in violation of the above statute.
<b>KRS 244.040(1) Non-Cash Sales: Brewer or Distributor</b>	On or about _____, 20__, and for an undetermined period of time prior thereto, the licensee, an agent, or employee, sold alcoholic beverages to persons for consideration other than by cash paid, in violation of the above statute.
<b>KRS 244.050 Treating</b>	On or about _____, 20__, and for an undetermined period of time prior thereto, the licensee sold, gave or delivered alcoholic beverages to persons for less than a full monetary consideration, in violation of the above statute.

<p>KRS 244.060(1) <b>Unauthorized Purchase</b></p>	<p>On or about _____, 20__, and continuing thereafter, the licensee, an agent, servant or employee, purchased alcoholic beverages from a person who was not licensed to sell same to licensee, in violation of the above statute. (with KRS 243.280 or KRS 243.250 or KRS 243.240)</p>
<p>KRS 244.060(2) <b>Unauthorized Sale</b></p>	<p>On or about _____, 20__, and continuing thereafter, the licensee, an agent, servant, or employee, sold alcoholic beverages (at wholesale to a person who was not a consumer or licensed to buy, receive or sell same)(to a person who was not legally authorized to buy and receive same), in violation of the above statute. (with licensing statute)(check for KRS 244.490 (beer) as separate charge).</p>
<p>KRS 244.080(1) <b>Sale to Under 21</b></p>	<p>(Aide) On or about _____, 20__, at approximately __:__ __.m., the licensee, an agent, servant or employee, at the licensed premises, sold, gave or delivered alcoholic beverages to a minor investigative aide with the Department of Alcoholic Beverage Control, in violation of the above statute.</p> <p><b>OR</b></p> <p>(Non-Aide) On or about _____, 20__, at approximately __:__ __.m., the licensee, an agent, servant or employee, at the licensed premises, sold, gave or delivered alcoholic beverages to _____, DOB __/__/__, a minor, in violation of the above statute.</p>
<p>KRS 244.080(2) <b>Sale to Intoxicated Person</b></p>	<p>On or about _____, 20__, at approximately __:__ __.m., the licensee, an agent, servant or employee, at the licensed premises, sold, gave or delivered alcoholic beverages to a person actually or apparently under the influence of alcoholic beverages, in violation of the above statute.</p>
<p>KRS 244.083 <b>Display Notice to Minors Sign</b></p>	<p>On or about _____, 20__, and for an undetermined period of time prior thereto, the licensee failed to post a printed card on the licensed premises which warned that persons under the age of twenty-one (21) were subject to a fine if they entered the premises to buy, possess, purchase or attempt to purchase, or misrepresented their age for the purpose of purchasing, alcoholic beverages, in violation of the above statute.</p>
<p>KRS 244.085(6) <b>Allow Under 21 on Premises</b></p>	<p>On or about _____, 20__, at approximately __:__ __.m., and for an undetermined period of time prior thereto, the licensee, an agent, servant or employee, permitted a person under twenty-one (21) years of age to remain on the licensed premises where alcoholic beverages are consumed or sold by the drink, in violation of the above statute.</p>

<p>KRS 244.087 <b>Employ Under 18</b> (With KRS 244.090)</p>	<p>On or about _____, 20__, at approximately __:__.m., the licensee, an agent, servant or employee, failed to have a person who was twenty (20) years old or older supervising an eighteen (18) year old employee who was accepting payment for malt beverages by the package, in violation of the above statutes.</p> <p style="text-align: center;"><b>OR</b></p> <p>On or about _____, 20__, at approximately __:__.m., the licensee, an agent, servant or employee, knowingly employed a person under the age of eighteen (18) years to accept payment for malt beverages by the package, in violation of the above statutes.</p>
<p>KRS 244.090(1)(a) <b>Employ a Felon</b></p>	<p>On or about _____, 20__, at approximately __:__.m., the licensee, an agent, servant or employee, knowingly employed a person who had been convicted of a felony within two (2) years of said date, in violation of the above statute.</p>
<p>KRS 244.090(1)(b) <b>Employ a Two-time Misdemeanant</b></p>	<p>On or about _____, 20__, at approximately __:__.m., the licensee, an agent, servant or employee, knowingly employed a person who had been twice convicted of misdemeanors directly or indirectly attributable to the use of alcoholic beverages within two (2) years, in violation of the above statute.</p>
<p>KRS 244.090(1)(c) <b>Employ Under 20</b></p>	<p>On or about _____, 20__, at approximately __:__.m., the licensee, an agent, servant or employee, knowingly employed a person under the age of twenty (20) years at the licensed premises, in violation of the above statute.</p>
<p>KRS 244.110 <b>Obstructed View</b></p>	<p>On or about _____, 20__, and for an undetermined period of time prior thereto, the licensee failed to furnish a clear or unobstructed view of the licensed premises from its entrance, in violation of the above statute.</p>
<p>KRS 244.120 <b>Disorderly Premises</b></p>	<p>On or about _____, 20__, at approximately __:__.m., and for an undetermined period of time prior thereto, the licensee, an agent, servant or employee, caused, suffered, or permitted the licensed premises to be disorderly whereby patrons engaged in fighting or in violent, tumultuous or threatening behavior, in violation of the above statute.</p> <p style="text-align: center;"><b>OR</b></p> <p>On or about _____, 20__, at approximately __:__.m., and for an undetermined period of time prior thereto, the licensee, an agent, servant or employee, caused, suffered, or permitted the licensed premises to be disorderly whereby employees or patrons made unreasonable noise, in</p>

	<p>violation of the above statute.</p> <p style="text-align: center;"><b>OR</b></p> <p>On or about _____, 20__, at approximately __:__.m., and for an undetermined period of time prior thereto, the licensee, an agent, servant or employee, caused, suffered, or permitted the licensed premises to be disorderly whereby employees or patrons possessed or used marijuana (or a controlled substance as described in KRS Chapter 218A), an offensive (and/or hazardous) act which serves no legitimate purpose, in violation of the above statute.</p> <p style="text-align: center;"><b>OR</b></p> <p>On or about _____, 20__, at approximately __:__.m., and for an undetermined period of time prior thereto, the licensee, an agent, servant or employee, caused, suffered, or permitted the licensed premises to be disorderly whereby employees or patrons _____, an offensive (and/or hazardous) act which serves no legitimate purpose, in violation of the above statute.</p> <p style="text-align: center;"><b>OR</b></p> <p>On or about _____, 20__, at approximately __:__.m., and for an undetermined period of time prior thereto, the licensee, an agent, servant or employee, caused, suffered, or permitted the licensed premises to be disorderly whereby patrons became manifestly under the influence of alcohol, an offensive and/or hazardous act which serves no legitimate purpose, in violation of the above statute.</p> <p>(check 804 KAR 5:060 for strip club violations if applicable).</p>
<p>KRS 244.150(1) (with 804 KAR 4:100) <b>Failure to Keep Records</b></p>	<p>On or about _____, 20__, at approximately __:__.m., and for an undetermined period of time prior thereto, the licensee failed to keep, maintain, or make readily available to the Department of Alcoholic Beverage Control, adequate books, records, invoices, and/or other documentation relating to all transactions involving alcoholic beverages, in violation of the above statute and regulation.</p>
<p>By KRS 244.160 (With KRS 243.020(1) and license authority statute by this statute) <b>Presumption of intent to sell</b></p>	<p>On or about _____, 20__, at approximately __:__.m., and for an undetermined period of time prior thereto, the licensee, an agent, servant or employee purchased for sale and/or sold distilled spirits (for consumption) without an appropriate license by keeping open containers of distilled spirits on the licensed premises, in violation of the above statutes.</p>

<p>KRS 244.165(1)(c) <b>Out of state shipments</b></p>	<p>On or about _____, 20__, (and for an undetermined period of time prior thereto,) the licensee, an agent, servant or employee, -----, in violation of the above statute.</p>
<p>KRS 244.167 <b>Retailers Purchase From Improper Distributor/Wholesaler</b></p>	<p>On or about _____, 20__, at approximately __:__.m., (and for an undetermined period of time prior thereto,) the licensee, an agent, servant or employee, purchased, ordered or received alcoholic beverages from a wholesaler (or distributor) who did not purchase the brand from the primary source of supply (or who is not the designated representative of the primary source of supply in the Commonwealth and who did not purchase the alcoholic beverage from the designated representative of the primary source of supply), in violation of the above statute</p> <p style="text-align: center;"><b>OR</b></p> <p>On or about _____, 20__, at approximately __:__.m., (and for an undetermined period of time prior thereto,) the licensee, an agent, servant or employee, purchased, ordered or received alcoholic beverages from a wholesaler (or distributor) who did not purchase the brand from the primary source of supply (or who is not the designated representative of the primary source of supply in the Commonwealth and who did not purchase the alcoholic beverage from the designated representative of the primary source of supply), in violation of the above statute.</p> <p style="text-align: center;"><b>OR</b></p> <p>On or about _____, 20____, (and for an undetermined period of time prior thereto,) the licensee, an agent, servant or employee, failed to unload and store alcoholic beverages in the licensee's warehouse for a time period of twenty-four (24) hours before being again transported, in violation of the above statute.</p>
<p>KRS 244.290(3) <b>Open on Sunday Sales/After Hours</b> (Distilled Spirits and Wine)</p>	<p>On or about _____, 20__, at approximately __:__.m., the licensee, an agent, servant or employee, permitted the licensed premises to remain open during the twenty-four (24) hours of a Sunday (or after midnight), in violation of the above statute.</p> <p style="text-align: center;"><b>OR</b></p> <p>On or about _____, 20__, at approximately __:__.m., the licensee, an agent, servant or employee, permitted the licensed premises to remain open during a Sunday at a time prohibited by the local governmental authority, in violation of the above statute.</p>

<p>KRS 244.300 <b>Credit Sales for Distilled Spirits and Wine</b></p>	<p>On or about _____, 20__, and for an undetermined period of time thereto, the licensee, an agent, servant or employee, at the licensed premise, sold, delivered or gave distilled spirits or wine on credit, in violation of the above statute.</p>
<p>KRS 244.310 <b>Containers that LD licensee may keep</b></p>	<p>On or about _____, 20__, (and for an undetermined period of time prior thereto,) the licensee, an agent, servant or employee, -----, in violation of the above statute.</p>
<p>KRS 244.330 <b>Unlicensed Supplemental Bar (with KRS 243.020)</b></p>	<p>On or about _____, 20__, (and for an undetermined period of time prior thereto,) the licensee, an agent, servant or employee, maintained more than one (1) bar at the licensed premises without an appropriate license, in violation of the above statutes.</p>
<p>KRS 244.340 <b>Containers that LP May Keep</b></p>	<p>On or about _____, 20__, (and for an undetermined period of time prior thereto,) the licensee, an agent, servant or employee, kept, on the licensed premises, distilled spirits or wine in a container other than the original container, in violation of the above statute.</p>
<p>KRS 244.350 <b>Deliveries by LP</b></p>	<p>On or about _____, 20__, at approximately __:__.m., , (and for an undetermined period of time prior thereto,) the licensee, an agent, servant or employee delivered distilled spirits or wine, in violation of the above statute. (with KRS 243.240).</p>
<p>KRS 244.360 <b>Display License Number (with 804 KAR 7:050)</b></p>	<p>On or about _____, 20__, and for an undetermined period of time prior thereto, the licensee failed to have printed on the front window of the licensed premises, the licensee's name together with the licensee's alcoholic beverage license number, in violation of the above statute and regulation.</p>
<p>KRS 244.440 <b>Selling of Non-Registered Brands</b></p>	<p>On or about _____, 20__, __, and for an undetermined period of time prior thereto, the licensee purchased alcoholic beverages which were not registered with the Department of Alcoholic Beverage Control, in violation of the above statute.</p>
<p>KRS 244.450 <b>Importing Without Distributing Rights</b></p>	<p>On or about _____, 20__, __, and for an undetermined period of time prior thereto, the licensee imported brands offered by a nonresident distiller, rectifier, blender, vintner or wholesaler without being granted distributing rights or obtaining an importer's permit, in violation of the above statute.</p>
<p>KRS 244.461 <b>Rebate Coupons</b></p>	<p>On or about _____, 20__, __, and for an undetermined period of time prior thereto, the licensee advertised or promoted the sale of distilled spirits or wine by use of rebate coupons, in violation of the above statute.</p> <p style="text-align: center;"><b>OR</b></p>

	On or about _____, 20__, __, and for an undetermined period of time prior thereto, the licensee advertised or promoted the sale of malt beverages by use of rebate coupons, in violation of the above statute.
<b>KRS 244.480(2) Sunday Sales After Hour Sales (Beer)</b>	On or about _____, 20__, at approximately __:__.m., the licensee, an agent, servant or employee, at the licensed premises, sold, gave or delivered malt beverages between midnight and 6 a.m. or during the twenty-four (24) hours of a Sunday, in violation of the above statute.  <b>OR</b>  On or about _____, 20__, at approximately __:__.m., the licensee, an agent, servant or employee, at the licensed premises, sold, gave or delivered malt beverages during the hours the polls were open on a primary or regular election day, in violation of the above statute.  <b>OR</b>  On or about _____, 20__, at approximately __:__.m., the licensee, an agent, servant or employee, at the licensed premises, sold, gave or delivered malt beverages on a Sunday at a time prohibited by the local governmental authority, in violation of the above statute.
<b>KRS 244.490 Sales To Unauthorized Seller of Beer (Bootlegger)</b>	On or about _____, 20__, at approximately __:__.m., (and for an undetermined period of time prior thereto,) the licensee, an agent, servant or employee, sold malt beverages to a person engaged in transporting and selling malt beverages in violation of KRS 242.230, in violation of the above statute. (Check KRS 242.270, KRS 242.280 and KRS 244.060(2)).
<b>KRS 244.510(1) Federal Law Requirements</b>	On or about _____, 20__, at approximately __:__.m., (and for an undetermined period of time prior thereto,) the licensee possessed alcoholic beverages without warning required by Federal law, in violation of the above statute.
<b>KRS 244.580 Exclusive Outlets Brands; Refuse to Sale/Provide Reasonable Service</b>	On or about _____, 20__, and for an undetermined period of time prior thereto, the licensee, an affiliate, subsidiary, agent, servant or employee, required a malt beverage retailer, directly or indirectly, to purchase malt beverages from it to the exclusion, in whole or in part, of malt beverages sold or offered for sale by other persons, in violation of the above statute
<b>KRS 244.585(1) Distributor Sales: Non Authorized Brands;</b>	On or about _____, 20__, and for an undetermined period of time prior thereto, the licensee, an agent, servant or employee, sold malt beverage brands without a written agreement with the brand supplier or brewer which authorized the licensee's sales of that brand where sold, in

<p><b>Refuse to Sale/Provide Reasonable Service</b></p>	<p>violation of the above statute.</p> <p style="text-align: center;"><b>OR</b></p> <p>On or about _____, 20__, and for an undetermined period of time prior thereto, the licensee, an agent, servant or employee, refused to sell or offer reasonable service to a licensed retailer for a malt beverage brand for which the licensee was the exclusive authorized distributor of said brand for the area where said retailer was located, in violation of the above statute.</p> <p style="text-align: center;"><b>OR</b></p> <p>On or about _____, 20__, and for an undetermined period of time prior thereto, the licensee, an agent, servant or employee, refused to sell or offer for sale to licensed retailers a malt beverage brand for which the licensee was the exclusive authorized distributor of said brand for the area where said retailers were located, in violation of the above statute.</p>
<p><b>KRS 244.585(3) Distributor Sales: Non Licensed Retailers, Outside Territory, Etc</b></p>	<p>On or about _____, 20__, and for an undetermined period of time prior thereto, the licensee, an agent, servant or employee, sold malt beverages to a non-licensed retailer, in violation of the above statute. (with KRS 243.020 and KRS 243.180 and KRS 244.060)</p> <p style="text-align: center;"><b>OR</b></p> <p>On or about _____, 20__, and for an undetermined period of time prior thereto, the licensee, an agent, servant or employee, sold a malt beverage brand outside the designated geographical territory as set forth in the written agreement between the licensee and the brand supplier or brewer which authorized the licensee's sales of that brand within a designated area, in violation of the above statute.</p> <p style="text-align: center;"><b>OR</b></p> <p>On or about _____, 20__, and for an undetermined period of time prior thereto, the licensee, an agent, servant or employee, sold a malt beverage brand without the prior written approval of the brand brewer or supplier, in violation of the above statute. (With KRS 244.585(1) as separate charge).</p>
<p><b>KRS 244.590(3) Tied Houses (Beer)</b></p>	<p>On or about _____, 20__, at approximately __:__ .m., (and for an undetermined period of time prior thereto,) the licensee furnished, gave, rented, lent, or sold to a retailer, equipment, fixtures, signs, supplies, money, services, or other things of value, in violation of the above statute.</p>

<p>KRS 244.600 <b>Commercial Bribery</b></p>	<p>On or about _____, 20__, (and for an undetermined period of time prior thereto,) the licensee, an agent, servant or employee, -----, in violation of the above statute.</p>
<p>KRS 244.600(4) <b>Paying for Retail Advertising</b></p>	<p>On or about _____, 20__, at approximately __:__.m., (and for an undetermined period of time prior thereto,) the licensee paid or credited a retailer for advertising, display or distribution services, in violation of the above statute.</p>
<p>804 KAR 1.100 <b>Advertising</b></p>	<p>On or about _____, 20__, __, and for an undetermined period of time prior thereto, the licensee ran an advertisement in the newspaper, _____, that persons under eighteen years of age were permitted on the licensed premises, in violation of the above regulation.</p> <p style="text-align: center;"><b>OR</b></p> <p>(Subsection 8). On or about _____, 20__, __, and for an undetermined period of time prior thereto, the licensee advertised a product, service or activity which the licensee was prohibited by statute or regulation from selling, providing or conducting, in violation of the above regulation.</p> <p style="text-align: center;"><b>OR</b></p> <p>(Subsection 7). On or about _____, 20__, __, and for an undetermined period of time prior thereto, the licensee ran an advertisement that used the term “free,” “complimentary” and/or other terms which inferred or suggested the giveaway of alcoholic beverages at the licensed premises, in violation of the above regulation.</p> <p style="text-align: center;"><b>OR</b></p> <p>(See 804 KAR 1:100 for other violations)</p>
<p>804 KAR 3:100 <b>Accepting Food Stamps for Alcohol Sale</b> (also add a KRS 243.490(1) charge)</p>	<p>On or about _____, 20__, at approximately __:__.m., the licensee, an agent, servant or employee, at the licensed premises, accepted U.S.D.A. food coupons in exchange for an alcoholic beverage, In violation of the above regulation.</p>
<p>804 KAR 4:100 <b>Failure to Keep Records</b></p>	<p>(See and join charge with KRS 244.150(1))</p>

<p>804 KAR 4:110, Section 1(1) <b>Failure to Conduct Business</b></p>	<p>On or about _____, 20__, __, and for a period not less than ninety (90) days prior thereto, the licensee failed to transact any business, said act constituting sufficient cause for license revocation pursuant to the above regulation.</p>
<p>804 KAR 5:070 Section 3 <b>Display of No Under 21 to Enter Sign</b></p>	<p>On or about _____, 20__, __, and for an undetermined period of time prior thereto, the licensee failed to post a printed card on the licensed premises which warned that persons under the age of twenty-one (21) were not to enter or remain on the premises, in violation of the above regulation.</p>
<p>804 KAR 7:050 <b>Display License Number</b></p>	<p>(See and join charge with KRS 244.360)</p>
<p>804 KAR 9:010 Section 2 (4)(a) <b>Failure to Maintain 50% Food Sales</b></p>	<p>(See and join charge with KRS 242.1295)</p>
<p>804 KAR 9:010 Section 2 (4)(b) <b>Restaurant 100 Seat Capacity</b></p>	<p>On or about _____, 20__, __, and for an undetermined period of time prior thereto, the licensee failed to maintain a minimum seating capacity of 100 people at tables, in violation of the above regulation.</p>
<p>804 KAR 9:010 Section 2 (4)(c) <b>Proof that Meet Restaurant Criteria</b></p>	<p>On or about _____, 20__, __, and for an undetermined period of time prior thereto, the licensee failed to provide satisfactory proof that the licensed premises meet the criteria for issuance of a restaurant drink license, in violation of the above regulation.</p>

**ECONOMIC DEVELOPMENT TOOLS FOR DOWNTOWN DEVELOPMENT:  
NEWPORT ON THE LEVEE: A CASE STUDY**  
James E. Parsons

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**I. NEWPORT ON THE LEVEE**

488,000 square feet mixed use Entertainment Center:

Investment:           \$200,000,000  
Jobs created:           1,400  
Tax impact:

State:           \$4,087,000 (3.2 million used a TDA incentive)  
City:           575,000  
Schools:       194,000  
County:       173,000

TOTAL:       \$5,029,000

Taxes before development:       \$231,000

Major tenants:

Newport Aquarium  
AMC Theatres  
Barnes & Noble  
Funny Bone Comedy Club  
Game Works  
Sixteen restaurants  
Retail & Office

Location: Approximately ten acres on Newport Riverfront

**II. INITIAL STEPS TAKEN BY CITY**

- A. City undertook visioning session and developed concept for entertainment district.
- B. Prepared and adopted a Redevelopment Plan per the provisions of KRS 99.330 to 99.510. Declared the area blighted as provided in KRS 99.340(2). The definition of “blighted area” is as follows:

“Blighted area” means an area (other than a slum area as defined in this section) whereby reason of the

predominance of defective or inadequate street layout, faulty lot layout in relation to size, adequacy, accessibility, or usefulness, submergency of lots by water or other unsanitary or unsafe conditions, deterioration of site improvements, diversity of ownership, tax delinquency, defective or unusual conditions of title, improper subdivision or obsolete platting, or any combination of such reasons, development of such blighted area (which may include some incidental buildings or improvements) into predominantly housing uses is being prevented.

C. Redevelopment Plan Allows:

1. City to control development in area -- KRS 99.380;
2. Allows use of eminent domain -- KRS 99.420;
3. Allows the transfer of property by City without receiving fair market value -- KRS 99.450.

Note: The recent amendments to the Eminent Domain Act, KRS 416.675(2)(c), keeps “[t]he acquisition and transfer of property for the purpose of eliminating blighted areas, slum areas, or substandard and unsanitary areas in accordance with KRS Chapter 99”, within the definition of “public use” for purposes of using eminent domain. However, there seems to be some confusion with that section and the provision in subsection (3) of the same statute that prohibits the use of eminent domain for the acquisition of private property for the transfer to a private person for the purpose of economic development.

### III. AQUARIUM DEVELOPMENT AGREEMENT

A. City Agreed to:

1. Acquire land needed and lease air rights to Aquarium.
2. Clear land and construct pile caps to allow for Aquarium construction.
3. Create parking.
4. Issue taxable bonds for Aquarium construction to exempt Aquarium from property taxes (KRS 132.200(7)).

5. Assist with obtaining \$5 million in state funds for needed road improvements to Kentucky Rt. 8.
6. Assist with qualifying project under the Tourism Development Act (TDA).

B. Aquarium Agreed to:

1. Build and operate Aquarium.
2. Pay base lease to city plus a surcharge on tickets to support city debt.
3. Aquarium qualified for Tourism Development Act Credit. KRS 139.536 and KRS 148.851-860.

**III. NEWPORT ON THE LEVEE DEVELOPMENT AGREEMENT**

A. City Agreed to:

1. Issue \$44 million tax exempt funds for public improvements (1,920 car parking garage, etc.)
2. Issue \$11 million taxable bonds for Plaza area.
3. Issue IRBs for Levee construction (property tax exemption).
4. Lease all air rights to Levee.

B. Levee Agreed to:

1. Lease and build Levee.
2. Qualified for TDA (needed statutory change), which generated a possible credit adjust sales taxes of \$40 million based on total development cost of \$160 million.
3. Pledged TDA sales tax credit to payment of debt issued by City.
4. Pay \$875,000 in PILOT programs to City to support City debt.
5. Be responsible for any debt service on City debt not covered by parking revenues, TDA pledge, PILOT pledge.
6. Contribute funds to Kentucky Rt. 8 improvements not covered by State funds.

#### **IV. TOOLS USED**

- A. City Risk
- B. Development Plan -- Chapter 99
- C. Eminent Domain (only one parcel required a full trial)
- D. Tourism Development Act
- E. Taxable Bonds
  - 1. Direct incentive for aquarium.
  - 2. Method of capturing property taxes (PILOT) to support debt.
- F. State Transportation Funds.

Note: The use of taxable bonds to create property tax exemptions now has certain additional procedural hurdles per KRS 103.210(1) if state revenues are impacted.

#### **V. NEW TOOL AVAILABLE**

- A. HB 549 (Tax Increment Financing)
  - 1. Local development area.
    - a. 1,000 acres, undeveloped land per year;
    - b. City and/or county may pledge 100 percent of incremental real property taxes and occupational taxes to support "project" within meaning of statute;
    - c. Other local taxing districts, except schools and fire districts, may contribute their incremental real property taxes by agreement.
  - 2. Developmental area Tax Increment Financings (TIFs).
    - a. Limited to three square contiguous miles of area.
    - b. Encourage reuse and reinvestment in areas where development not likely to occur without public assistance.

- c. City or county must find that area meets two or more of the following conditions:
  - i. Substantial loss of residential, commercial or industrial activity.
  - ii. Forty percent or more of the households are low-income households.
  - iii. More than 50 percent of residential, commercial or industrial structures are deteriorating or deteriorated.
  - iv. Substantial abandonment of residential, commercial or industrial structures.
  - v. Substantial presence of environmentally contaminated land.
  - vi. Inadequate public improvements or substantial deterioration in public infrastructure; or
  - vii. Any combination of factors that impedes the growth of the City or county; impedes the provision of adequate housing; impedes the development of commercial or industrial property or adversity affects public health, safety or general welfare due to the development area's present condition and use.
  
- d. City or county must also find:
  - i. That the area is not reasonably expected to develop without public assistance.
  - ii. That the public benefits of the development area justify the public costs proposed.
  - iii. That the area immediately surrounding the development area has not been subject to growth and development through private investment.

## **VI. STATE PARTICIPATION IN TAX INCREMENT FINANCING (TIF) AREAS**

In addition to local taxes to support projects within TIF Districts, the Act creates three State participation programs for development area TIF Districts.

### **A. Commonwealth Participation Program for State Real Property *Ad Valorem* Tax Revenues**

1. Allows up to 100 percent of state real property taxes to be pledged to support new public infrastructure to support private investment.
2. Must be new economic activity in Kentucky.
3. Minimum capital investment of \$10 million.
4. Not more than 20 percent of square footage or 20 percent of capital investment to retail space.

### **B. Signature Project Program**

1. Up to 80 percent of incremental state revenues, real property, sales taxes, corporate income taxes, and income taxes to support needed infrastructure and approved signature project costs.
2. Incorporates most provisions of development area TIF, with certain exceptions.
3. Minimum investment of \$200 million.

### **C. Commonwealth Participation Program for Mixed Use Redevelopment in Blighted Urban Areas**

1. Up to 80 percent of incremental state revenues to pay for:
  - a. Public infrastructure costs;
  - b. Costs associated with:
    - i. Land preparation.
    - ii. Demolition.
    - iii. Clearance.

2. Mixed use project (not more than 20 percent retail).
3. Minimum investment of \$20 million.
4. No retail establishment that exceeds 20,000 square feet.

## **BANKRUPTCY COLLECTION AND RELATED ISSUES FOR GOVERNMENTAL AUTHORITIES**

Richard L. Ferrell

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### **I. OVERVIEW OF RELEVANT CONSIDERATIONS FOR GOVERNMENTAL AUTHORITIES WHEN A DEBTOR COMMENCES A BANKRUPTCY CASE**

- A. Nature of the Bankruptcy Proceeding (Chapter 7 vs. 13 vs. 11)
- B. Nature of the Debtor (Individual, Spouses, Corporation, Partnership, etc.)
- C. Imposition of the Automatic Stay, Precluding Efforts to Collect or Enforce a Debt
- D. Continuing Liability of Non-Bankrupt Co-Liable Parties (Insiders, Responsible Officers, Guarantors)
- E. Nature of the Governmental Authorities' Claim or Concern
- F. Prerequisites and Procedures for Action to Be Taken by Governmental Authority on a Debt, Claim or Obligation Owing by a Debtor which Has Commenced a Bankruptcy Proceeding
- G. Potential Preference Exposure
- H. Declaring Debts Non-Dischargeable

### **II. NATURE OF THE BANKRUPTCY PROCEEDING**

- A. Chapter 7 (liquidation)
  - 1. Who may commence a Chapter 7 case.
    - a. Section 109(b) of the Bankruptcy Code provides that only a person may be a debtor under Chapter 7.
    - b. Section 101(41) of the Bankruptcy Code defines "person" as including an individual, partnership or corporation.
    - c. There are many new, additional eligibility requirements that an individual must satisfy in order to commence and maintain a Chapter 7 bankruptcy case

pursuant to the Bankruptcy Abuse, Consumer Protection Act ("BAPCPA") that went into effect on October 17, 2005, such as "means testing" under Section 707 of the Bankruptcy Code. These additional requirements are beyond the scope of this presentation.

2. Process and proceedings in Chapter 7.
  - a. Chapter 7 Trustee appointed whom, pursuant to Sections 541 and 704 of the Bankruptcy Code, succeeds to all the Debtor's legal and equitable interests in non-exempt property, is obligated to take charge of and liquidate that property and make distributions to creditors which have filed proofs of claim which are allowed.
  - b. Pursuant to Sections 501 and 502 of the Bankruptcy Code, creditors who believe they have claims against the Debtor will be required to file proofs of claim with the court by a deadline to be set by the court pursuant to a notice issued to creditors in order to share in any distributions to be made by the Chapter 7 Bankruptcy Trustee.

Governmental entities are authorized and required to file proofs of claim with the court in order to share in distributions made by the Chapter 7 Bankruptcy Trustee.

- c. Pursuant to Section 727 of the Bankruptcy Code, an individual debtor is granted a discharge after fulfilling his/her obligations in Chapter 7 unless certain exceptions are triggered (corporate/business entities which file Chapter 7 are not granted a discharge).
- B. Chapter 13 (Repayment Plan)
  1. Who may commence a Chapter 13 case.
    - a. Only an individual (not a corporation, partnership or other business enterprise), may commence a Chapter 13 pursuant to Section 109(c) of the Bankruptcy Code.

- b. To be eligible to commence a Chapter 13 Bankruptcy case, the individual must have "regular income" and owe, as of the date of the filing of the bankruptcy petition, non-contingent, liquidated, unsecured debts of less than \$307,675 and non-contingent, liquidated, secured debts of less than \$922,975, or an individual with regular income and such individual's spouse that owe on the date of the filing of the bankruptcy petition, non-contingent, liquidated, unsecured debts that aggregate less than \$307,675 and non-contingent, liquidated, secured debts of less than \$922,975. (See Section 109(c) of the Bankruptcy Code).
  - 2. Process and proceedings in Chapter 13.
    - a. Pursuant to Section 1306(b) of the Bankruptcy Code a debtor remains in possession of all of his property in Chapter 13.
    - b. Pursuant to Section 1302 of the Bankruptcy Code, a Standing Chapter 13 Trustee for a given region may be appointed by the Office of the U.S. Trustee to oversee all Chapter 13 cases in that region, and ensure that the debtor complies with its duties and makes the payments required by Chapter 13.
    - c. Sections 1321, 1322 and 1325 of the Bankruptcy Code require the debtor to file a Chapter 13 plan for the repayment and treatment of its creditors over either a three-year or five-year period.
    - d. Debtor is not granted a discharge in Chapter 13 until completion of all his/her plan payments is made pursuant to Section 1328(a) of the Bankruptcy Code, and that discharge is subject to exceptions.
- C. Chapter 11 (Liquidation or Reorganization)
- 1. Who may commence a Chapter 11 case?

It must be a "person" -- defined in Section 101(41) of the Bankruptcy Code as including an individual, partnership or corporation (other corporate entities, such as LLC and LLPs have also been permitted to commence a Chapter 11 case).
  - 2. Process and proceedings in Chapter 11.

- a. Pursuant to Sections 1107 and 1108 of the Bankruptcy Code, the person or entity which commences the Chapter 11 case is permitted to remain in possession and control of its assets and business and to operate same as a "debtor-in-possession."
- b. An "Official Committee of Unsecured Creditors" ("Creditors' Committee") is appointed by the Office of the United States Trustee ("US Trustee") typically consisting of several of the debtor's largest unsecured creditors selected from a list of the top twenty largest unsecured creditors pursuant to Section 1102 of the Bankruptcy Code.

The Creditors' Committee has various rights and powers of oversight and input into the Debtor's business and the formulation of a plan of reorganization to exit bankruptcy conferred by Section 1103 of the Bankruptcy Code.

- c. Section 1102 authorizes the US Trustee to appoint additional or replacement members of the Creditors' Committee if appropriate and to appoint other official committees of other constituencies of the debtor, such as bondholders and/or equityholders.
- d. Chapter 11 is the only Chapter where it may not be necessary for a creditor to file a proof of claim to preserve its claim and rights to participate in a distribution which may be made in a Chapter 11 plan. Section 1111(a) of the Bankruptcy Code provides that a creditor is deemed to have filed a proof of claim if the debtor has listed the creditor in its bankruptcy schedules filed with the court as holding a claim, unless the claim is scheduled by the debtor as disputed, contingent or unliquidated (in which case, the creditor must file a proof of claim with the court to preserve its claim in the bankruptcy; likewise, if the creditor disagrees with the amount of the claim scheduled by the debtor, a proof of claim should be filed).
- e. A debtor in Chapter 11 may seek to simply liquidate some or all of its assets pursuant to Section 363 of

the Bankruptcy Code by either an auction/public sale or a private sale, following the filing of a motion with the Court seeking approval of such sale and proper notice given to creditors and opportunity to object.

Following such a liquidation sale, the debtor may seek to distribute proceeds to senior, secured creditors and either convert its case to one under Chapter 7, dismiss its case (if no proceeds or assets remain to liquidate), or file a "plan of liquidation" providing for the distribution of the remaining assets.

- f. A debtor in Chapter 11 may also propose a plan of reorganization to exit bankruptcy pursuant to Section 1121 of the Bankruptcy Code.
  - i. This proposed plan must be voted on by creditors and approved by the court as, among other things, "fair and equitable" in its treatment of creditors pursuant to Section 1129 of the Bankruptcy Code.
  - ii. Pursuant to Section 1141 of the Bankruptcy Code, if the Bankruptcy Court "confirms" or approves a corporate/non-individual debtor's proposed plan, the debtor receives a discharge of its debts, unless the plan calls for the liquidation of substantially all of the debtor's assets. In the case of an individual, the discharge is granted when the debtor completes making payments to creditors required under the plan.

### **III. IMPACT OF THE BANKRUPTCY CODE'S AUTOMATIC STAY**

- A. Section 362 of the Bankruptcy Code imposes, by operation of law, a (temporary) automatic stay/prohibition against any entity, including any governmental entity, from proceeding to attempt to collect a "pre-petition debt" against the debtor -- this is referred to as the "breathing spell."
  - 1. The "automatic stay" is very broad, and prohibits the commencement or continuation of any act or proceeding:
    - a. To recover a claim against the debtor that arose before the bankruptcy filing;

- b. To enforce against the debtor or property of the debtor's estate, any judgment obtained prior to the bankruptcy filing;
  - c. To obtain possession of or exercise control over property of the debtor's bankruptcy estate.
  - d. To create, perfect or enforce any lien against property of the debtor's estate;
  - e. To "collect, assess or recover a claim against the debtor that arose prior to the debtor's bankruptcy filing";
  - f. To setoff any debt owing to the debtor that arose prior to the debtor's bankruptcy filing against any claim against the debtor.
2. It has been held that governmental agencies which place even temporary "freezes" or "holds" on funds/payments otherwise payable to a debtor once the debtor files bankruptcy are in violation of the automatic stay. United States v. Reynolds, 764 F.2d 1004 (4th Cir. 1985); Small Business Administration v. Rinehart, 887 F.2d 165 (8th Cir. 1989).
3. Consequences of a creditor violating the automatic stay are two-fold:
- a. Any actions taken in violation of the automatic stay are void or voidable. Easley v. Pettibone Michigan Corp., 990 F.2d 905 (6th Cir. 1993); and
  - b. Pursuant to Section 362(k)(1) of the Bankruptcy Code, damages may be assessed by the court against the creditor for a willful violation of the automatic stay which may include actual damages, costs and attorneys fees and "in appropriate circumstances", punitive damages.

## B. Exceptions to the Automatic Stay

1. Section 362(b)(4) provides that the automatic stay does not apply to acts or proceedings by governmental units "to

enforce such governmental unit's policy or regulatory powers."

- a. "Police or regulatory powers refers to the enforcement of laws ***affecting health, welfare, morals and safety***, but not regulatory laws that conflict with the control of the res [property] of the Bankruptcy Court." In re Dan Hixson Chevrolet Co., 12 B.R. 917 (Bkrcty. Tex. 1981); Missouri v. Lindsey, 647 F.2d 768 (5th Cir. 1981).
- b. Even non-debt collection related governmental actions taken post-bankruptcy which affect a debtor may be deemed a violation of the automatic stay, such as a regulatory agency's decision to terminate a motor vehicle dealer franchise due to the debtor's bankruptcy filing. Dan Hixon Chevrolet, 12 B.R. 917.

2. Eminent domain proceedings as an exception.

General rule is that, where the taking by the governmental entity is for a commercial or profit-oriented purpose, as opposed to a health or safety purpose, the police or regulatory powers exception does not apply and the automatic stay prohibits the eminent domain proceeding from continuing.

- a. In re PMI-DVW Real Estate Holdings, L.L.P., 240 B.R. 24 (Bkrcty.D.Ariz. 1999) (county's proposed condemnation for the purpose of road realignment was subject to automatic stay. It was not shown to be in furtherance of police or regulatory power because traditionally that exception to the automatic stay is applied where there is an "imminent health, safety or welfare issue" such that the government has a special need to protect its citizens, as in the case of a building condemned as a fire hazard).
- b. In re Altamirco, 56 B.R. 199 (Bkrcty.C.D. Cal. 1986) (municipal redevelopment agency's attempt to exercise eminent domain to redevelop debtor's property into a commercial complex with a hotel was not exempt from the automatic stay as an exercise of the agency's police or regulatory power).

- c. In re Javens, 107 F.3d 359 (6th Cir. 1997) (municipality could exercise eminent domain to demolish deteriorated buildings posing hazard to neighborhood as police or regulatory power excepted from automatic stay, since the municipality was not acting to further its pecuniary interest).
  3. Pursuant to Sections 362(b)(1) and (2) the automatic stay does not bar the commencement or continuation of:
    - a. Criminal proceedings,
    - b. Civil proceedings to establish paternity or establish or modify domestic support obligations, dissolution of marriage (except insofar as the dissolution would seek to determine the division of property that is property of the debtor's bankruptcy estate),
    - c. Proceedings for the **collection of domestic support obligations**,
    - d. Proceedings for the withholdings, suspension or restriction of a driver's license, professional or occupational license or recreational license.
  4. Pursuant to Section 362(b)(9), the automatic stay does not preclude (i) an audit by a governmental unit to determine tax liability; (ii) the issuance by a governmental unit of a notice of tax deficiency; or (iii) the making of any assessment for any tax, and issuance of a notice and demand for payment.
  5. Pursuant to Section 362(b)(18), the automatic stay does not preclude the creation or perfection of a statutory lien for *ad valorem* property taxes or a special assessment on real property, if such tax or assessment comes due after the date of the filing of the debtor's bankruptcy case.
- C. Right of Creditor to Seek Relief from the Automatic Stay
  1. Section 362(d) of the Bankruptcy Code provides that a party in interest may file a motion asking the Bankruptcy Court to grant it relief from the automatic stay for certain purposes "for cause", including a lack of adequate protection in property in which the party has an interest.

- a. Cause is not defined in the Bankruptcy Code and simply involves a facts and circumstances analysis.
- b. It has been held that the passage of time is relevant to determining whether granting relief from the automatic stay so that, if through a long passage of time in bankruptcy, the collection rights of the government will be "inappropriately defeated," the government may be granted relief from the automatic stay. In re Nolan, 205 B.R. 885 (Bkrcty.M.D.Tenn. 1997).

#### **IV. CONTINUING LIABILITY OF NON-BANKRUPT CO-LIABLE PARTIES**

- A. Except in Chapter 13 cases, it is well-settled that the automatic stay does not apply to non-bankrupt co-debtors or guarantors of an obligation. Winters by and through McMahon v. George Mason Bank, 94 F.3d 130 (4th Cir. 1996); Credit Alliance Corp. v. Williams, 851 F.2d 119 (4th Cir. 1988).
- B. In rare cases, where it is shown that certain officers or insiders of a business which has filed Chapter 11 are essential to the reorganization and that defending individual lawsuits for obligations that the officers or insiders are co-liable for would have an extremely adverse impact and distraction on the reorganization effort, the Bankruptcy Court can use its equitable powers granted by Section 105 of the Bankruptcy Code to extend the automatic stay to such officers and insiders. In re Sprint Corp. Securities Litigation, 232 F.Supp.2d 1193 (D.Kan. 2002).
- C. Unless the automatic stay is expressly extended, a creditor, including a governmental unit, is free to proceed with collection action against a non-bankrupt co-liable third party.
- D. Chapter 13 Co-Debtor Stay
  1. The rule that the automatic stay does not apply to non-bankrupt, co-liable third parties is reversed in the case of a Chapter 13 debtor.
  2. Section 1301(c) of the Bankruptcy Code states that once a debtor files a Chapter 13 case, "a creditor may not act, or commence or continue any civil action to collect all or any part of a consumer debt of the debtor from any individual that is liable on the debt with the debtor. . ."

3. The Chapter 13 co-debtor stay applies by operation of law as soon as a Chapter 13 case is commenced to void any action taken in violation of the stay and applies to any non-bankrupt party who is jointly liable on the debt with the debtor whether by guaranty or otherwise. Patti v. Fred Ehrlich, PC, 304 B.R. 182, 188 (E.D. Pa. 2003); In re Jones, 106 B.R. 33 (Bkrtcy. W.D. N.Y. 1989); In re Pardue, 143 BR 434 (Bkrtcy.E.D. TX 1992).
4. The Chapter 13 co-debtor automatic stay remains in place until the debtor's plan is completed, at which point, if there is any deficiency still owed to the creditor, it may still pursue the non-bankrupt co-debtor for the deficiency. In re: Bonanno, 78 B.R. 52, 57 (Bkrtcy. E.D. Pa. 1987)

## V. NATURE OF CLAIM TO BE FILED OR ASSERTED BY THE GOVERNMENTAL AUTHORITY

### A. Secured Claims

1. Section 506(a) of the Bankruptcy Code provides that:

An allowed claim of a creditor secured by property, in which the estate has an interest or, or that is subject to setoff under Section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property. . .
2. The courts have uniformly recognized that a secured creditor with either a consensual or non-consensual lien, including a tax lien, need not, as a general rule, take any action to preserve its security interest/lien in the debtor's bankruptcy; the lien will pass through the bankruptcy unaffected unless the debtor or trustee seeks to specifically modify it by motion or in a plan.
  - a. 40235 Washington Street Corp. v. W.C. Lusardi, 177 F.Supp. 2d 1090 (S.D.Cal. 2001) (a tax lien on real property passed through the debtor's bankruptcy unaffected, remaining a secured claim against the property; although the debtor/trustee may, however bifurcate the tax claim into a secured component, which passes through the bankruptcy and an unsecured deficiency component, which is discharged).

- b. Kuebler v. IRS, 172 B.R. 595 (E.D. Ark. 1994) (Where debtor's Chapter 13 plan did not specifically address the IRS' tax lien, the lien passed through the bankruptcy, remaining enforceable *in rem* after the debtor was granted a discharge).
  - c. In re McLarry, 273 B.R. 753 (Bkrtcy. S.D. Tex. 2002) (A secured creditor, including the holder of state statutory lien, need not seek to have its claim either filed in or allowed by the Bankruptcy Court in order for it to survive the bankruptcy unless the debtor has sought to have the Bankruptcy Court disallow it).
  - d. In re Clark, 205 B.R. 140 (Bkrtcy. S.D. Ill. 1997) (secured lien passes through bankruptcy unaffected and creditor holding such lien may look to its lien to satisfy its debt even after the debtor receives a discharge).
3. Under what has become known as the "Absolute Priority Rule", a secured creditor in a bankruptcy must be paid/satisfied in full ahead of junior creditors of the debtor. In re Armstrong World Industries, Inc., 320 B.R. 523 (D. Del. 2005).

## B. Priority Claims

1. Section 507(a)(8) of the Bankruptcy Code creates what is known as a "priority" claim position for unsecured claims of governmental units to the extent that such claims are for:
  - (A) a tax on or measured by income or gross receipts for a taxable year ending on or before the date of the filing of the petition-
    - (i) for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition;
    - (ii) assessed within 240 days before the date of the filing of the petition, exclusive of (I) any time during which an offer in compromise with respect to that tax was pending or in effect during that 240-day period, plus 30 days; and (II) any time during which a stay or proceedings against collections was in effect in

a prior case under this title during that 240-day period, plus 90 days;

(B) a property tax incurred before the commencement of the case and last payable without penalty after one year before the date of the filing of the petition;

(C) a tax required to be collected or withheld and for which the debtor is liable in whatever capacity;

(D) an employment tax on a wage, salary or commission . . . earned from the debtor before the date of the filing of petition, whether or not actually paid before such date, for which a return is last due, under applicable law or under any extension, after three years before the date of the filing of the petition;

(E) an excise tax on-

(i) a transaction occurring before the date of the filing of the petition for which a return, if required, is last due, under applicable law or under any extension, after three years before the date of the filing of the petition; . . .

. . . .

(G) a penalty related to a claim of a kind specified in this paragraph and in compensation for actual pecuniary loss.

2. Priority claims, such as priority tax claims, must be paid in full before any distributions may be made to any junior, unsecured creditors of the debtor. In re C.J. Milligan, Inc., 252 B.R. 465 (Bkrtcy. E.D. MO. 2000); In re Vinnie, 345 B.R. 386 (Bkrtcy. M.D. Ala. 2006).

### C. Unsecured Claims

Sections 501 and 502 of the Bankruptcy Code provide that a creditor may file a proof of claim for the unpaid amounts it is owed as of the time of the bankruptcy filing and that a properly filed proof of claim is *prima facie* valid unless some party interest, including the debtor or trustee, successfully objects to its allowance in the

bankruptcy case. In re Maylin, 155 B.R. 605 (Bkrcty. D. Maine 1993).

D. Post-Petition/Administrative Expense Claims

Pursuant to Section 503 of the Bankruptcy Code, ordinary course obligations of a debtor that arise after the debtor files a bankruptcy case (including tax and other governmental claims) are deemed to be "post-petition" administrative expenses which may be paid by the debtor or trustee in the ordinary course when the obligation comes due or, if they are not paid, upon filing of a motion by the creditor for allowance and payment of the claim. In re Westmoreland Coal Co., 213 B.R. 1 (Bkrcty. D. Colo. 1997); In re Holley Garden Apartments, Ltd., 238 B.R. 488 (Bkrcty. M.D. Fla. 1999); In re Hyman Freightways, Inc., 342 B.R. 575 (Bkrcty. D. Minn. 2006).

E. Exercise of Set-off and/or Recoupment Rights

1. While both the set-off and recoupment doctrines share some common ground, there are key differences:
  - a. Set-off claims are subject to the Bankruptcy Code's automatic stay (and cannot be exercised after a bankruptcy case is filed without obtaining relief from the automatic stay) whereas recoupment is not;
  - b. Set-off rights are expressly incorporated into the Bankruptcy Code by statute -- Section 362 and 553, while recoupment, in contrast, is an equitable doctrine incorporated into the bankruptcy laws through common law and not by statute; and
  - c. While set-off allows the offset of mutual, pre-bankruptcy debts which arose from separate transactions, recoupment involves the offsetting of mutual debts which arose from the same set of "integrated transactions", regardless of whether the debts arose before or after the bankruptcy case was filed. In re Malinowski, 156 F.3d 131 (2d Cir. 1998); In re McMahon, 129 F.3d 93 (2d Cir. 1997).
2. Section 553(a) of the Bankruptcy Code regarding set-off provides that:

Except as otherwise provided in this section and sections 362 [the automatic stay] and 363 [use or disposition of property of the bankruptcy estate], this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title. . . except to the extent that. . .the debt owed to the debtor by such creditor was incurred by such creditor: (A) after 90 days before the date of the filing of the bankruptcy petition, (B) while the debtor was insolvent, and (C) for the purpose of obtaining a right of setoff against the debtor. . .

3. The "improvement in position" exception to setoffs contained in Section 553(b) of the Bankruptcy Code then provides that:

. . .[I]f a creditor offsets a mutual debt owing to the debtor against a claim against the debtor on or within 90 days before the filing of the bankruptcy petition, then the trustee may recover from such creditor the amount so offset to the extent that any insufficiency on the date of such setoff is less than the insufficiency on the later of (A) 90 days before the filing of the bankruptcy petition, and (B) the first date during the 90 days immediately preceding the date of the filing of the bankruptcy petition on which there is an insufficiency.

"Insufficiency" is defined in Section 553(b)(2) of the Bankruptcy Code as the amount, if any, by which a claim against the debtor exceeds a mutual debt owing to the debtor by the holder of such claim.

4. Overpayments by the government made to the debtor have been an often litigated subject of set-off and recoupment when the governmental authority later seeks to reduce future payments on a given program as an offset for the earlier overpayments.
  - a. Medicare and Medicaid overpayments have been held to constitute a valid basis for the governmental authority to recoup by reducing future payments to be otherwise made to the provider following a

bankruptcy, which would not violate the Bankruptcy Code's automatic stay. In re Holyoke Nursing Home, 372 F.3d 1 (1st Cir. 2004)

- b. Similarly, unemployment compensation overpayments have been held to constitute a valid basis to recoup later payments through future reductions. In re Ross, 104 B.R. 171 (E.D.Mo. 1989); *but see* In re Malinowski, 156 F.3d 131 (refusing to permit recoupment of unemployment benefit overpayments against future payments owed in future years)
  - c. In short, if there is a governmental program otherwise entitling the debtor to future payments from the governmental authority, then, upon filing of the debtor's bankruptcy, the governmental authority will need to determine:
    - i. Whether any prior overpayments made by the government, if any, would be more properly characterized as arising from separate transactions (set-off) or the same set of transactions (recoupment).
    - ii. If the payments are more properly characterized as arising from separate transactions (set-off), whether the government should seek relief from the automatic stay to enforce the set-off before the payment becomes due in the ordinary course and could give rise to a claim of violation of the automatic stay if not timely paid.
5. Under the BAPCPA Amendments to the Bankruptcy Code, a new exception to the automatic stay has now been created to allow a **setoff of a tax refund** otherwise owed by a governmental unit with respect to a taxable period that ended before the date of the bankruptcy **against an income tax liability** for a taxable period that also ended before the date of the bankruptcy.

**VI. PREREQUISITES AND PROCEDURES FOR ACTION TO BE TAKEN BY A GOVERNMENTAL AUTHORITY ON A DEBT OWED BY A DEBTOR**

- A. File a proof of claim for any pre-bankruptcy amounts owed and properly categorize such amounts as secured, priority or unsecured.
- B. File an administrative expense application for any amounts which come due after the bankruptcy case is filed and which are not paid timely in the ordinary course.
- C. If adequate "cause" exists, file a motion for relief from the automatic stay to enforce the governmental obligation outside of bankruptcy, such as:
  - 1. Exercise of set-off right;
  - 2. Judicial execution/foreclosure of lien against real estate or other property.
- D. If unfair or otherwise impermissible treatment proposed of the governmental authorities' claim is proposed in a Chapter 11 or Chapter 13, object to confirmation of the plan.
  - 1. Section 1129(a)(9)(C) of the Bankruptcy Code provides that in order for the Bankruptcy Court to be statutorily authorized to "confirm" (approve) a debtor's proposed plan of reorganization (which allows it to exit bankruptcy), then, with respect to a claim of a kind specified in Section 507(a)(8) of the Bankruptcy Code (*i.e.* those unsecured, pre-petition tax obligations listed therein), the plan of reorganization must provide that, upon approval by the Court of the plan of reorganization:

the holder of the [tax] claim will receive on account of such [tax] claim, regular installment payments in cash (i) of a total value as of the effective date of the plan, equal to the allowed amount of such claim; (ii) over a period ending not later than 5 years after the date [that the bankruptcy case was commenced]; and (iii) in a manner not less favorable than the most favored nonpriority unsecured claim provided for by the plan. . .

## VII. PREFERENCE EXPOSURE

Until recently, there was a split of authority on whether and how a state governmental authority could be subject to suit in the Bankruptcy Court to require it to return an alleged "preferential" payment or other property of a debtor which the governmental authority received or retained prior to the debtor's bankruptcy filing.

In Central Virginia Community College v. Katz, 546 U.S. 356 (2006), the Court, in a 5-4 decision, held that states/state agencies were subject to lawsuits in the Bankruptcy Court brought by a debtor/trustee to recover alleged preference payments and that sovereign immunity did not bar such suits.

## VIII. NON-DISCHARGEABILITY OF GOVERNMENTAL OBLIGATIONS AND/OR TAXES

A. Section 523 of the Bankruptcy Code, which governs the non-dischargeability of certain debts including tax obligations of individuals, provides that a general discharge in bankruptcy will not discharge an individual debtor from any debt:

(1)(A) for a tax of the kind and for the periods specified in Section 507(a)(8) of the Bankruptcy Code

(7) to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss, other than a tax penalty-

(A) relating to a tax of a kind not specified in paragraph (1); or

(B) imposed with respect to a transaction or event that occurred before three years before the date of the filing of the [bankruptcy].

B. If the tax obligation at issue relates to taxes which qualify as federal or state trust fund taxes, then the Bankruptcy Courts have been fairly uniform that, regardless of whether the debtor actually collected the taxes or not, the personal liability of the responsible officer/insider is non-dischargeable if the insider files a personal bankruptcy. See, e.g. DeChiaro v. New York State Tax Comm'n, 760 F.2d 432 (2d Cir. 1985) (state sales tax obligation was a trust fund tax obligation and was non-dischargeable); Matter of Taylor, 132 F.3d 256 (5th Cir. 1998) (personal liability of responsible

officers for pecuniary loss penalties due to IRS for unpaid trust fund taxes is non-dischargeable in the officers' personal bankruptcy); In re Thomas, 222 B.R. 742 (Bkrtcy. E.D. Pa.1998) (IRS's claim under pecuniary loss penalty statute imposing personal liability against responsible officers for unpaid trust fund taxes was a non-dischargeable obligation of the officer); In re Mosbrucker, 220 B.R. 656 (Bkrtcy. D. N.D. 1998) (same); Malcuit v. State of Texas, 134 B.R. 185 (N.D.Tex. 1991) (trust fund tax provision of Bankruptcy Code excepts from discharge taxes required to be collected from third-parties); In re St. Hilaire, 135 B.R. 186 (D. Mass. 1991) (trust fund taxes, including employment taxes the employer must withhold from the employees' wages, such as income and FICA, are never subject to discharge in bankruptcy).