

UNITED STATES BANKRUPTCY COURT

DISTRICT OF HAWAII

In re) Case No. 02-01948
) Chapter 7
 OSAMU TAUKEIAHO,)
)
 Debtor.)
 _____)

**MEMORANDUM DECISION
CONCERNING ALLEGED VIOLATION OF THE AUTOMATIC STAY**

I. INTRODUCTION

The Motion for Order Establishing Violation of the Automatic Stay and Request for Damages and to Set Aside State of Hawaii Judgment as Void, filed by the Debtor on August 20, 2002, was heard on September 18, 2002. Rustam A. Barbee, Esq., appeared for Debtor Osamu Taukeiaho; Cynthia S. Nakamura, Esq., appeared for creditors Leslie Keliimoeanu Lum II and Tina Nicole Lum; and Gary B. K. T. Lee, Esq., appeared for the Contractors License Board (“CLB”).

The parties have submitted extensive memoranda and declarations. There are no disputed questions of relevant fact and the motion can be decided as a matter of law.

II. FACTUAL BACKGROUND

On January 30, 2002, the Lums filed a complaint in state court against the Debtor. The Lums alleged that the Debtor had entered into a construction contract with them and that the Debtor had breached the contract in numerous respects. Following a trial, the state court entered a judgment against the Debtor in the amount of \$25,627.13. The state court found that the “Defendant never completed the job”; “Defendant failed to perform the remedial work to cure

the construction deficiencies, and did not install the two gates as called for in the contract”; and “The photographs in evidence and the witness’ testimony established that there were numerous deficiencies in the work performed by Defendant” The state court concluded that “Defendant breached his contractual duty to perform the work on Plaintiffs’ project in a workmanlike manner and engaged in substandard workmanship.” On May 21, 2002, the Debtor filed a notice of appeal.

The Debtor filed his chapter 7 bankruptcy petition on May 24, 2002. The Debtor listed the Lums as creditors in his Schedule F, Creditors Holding Unsecured Nonpriority Claims, reporting the pre-petition state court judgment for \$25,627.13. Neither the Lums nor any other party in interest timely objected to the Debtor’s discharge or timely sought a determination of the dischargeability of any particular debt in bankruptcy. The court entered a discharge of the Debtor under 11 U.S.C. § 727 on August 28, 2002.

On August 1, 2002, the Lums filed a motion in state court for an order directing the CLB to pay a portion of the Lums’ judgment against the Debtor out of the Contractors Recovery Fund (the “Fund”).¹ The Lums alleged that the Debtor’s conduct constituted violations of Haw. Rev. Stat. chapter 444. The Debtor filed a response that notified the state court of his chapter 7 bankruptcy filing and argued that, by filing the motion, the Lums had violated the automatic stay. The Debtor also argued that there was no finding at trial that the Debtor violated Haw.

¹Haw. Rev. Stat. chapter 444 provides for the licensing and regulation of building contractors by the CLB. Pursuant to Haw. Rev. Stat. § 444-26, persons who are injured by the conduct of a licensed contractor that violates chapter 444 may recover their damages, up to \$12,500, from the Fund. The CLB administers and controls the Fund. *Id.* § 444-29. The money in the Fund comes from fees and assessments paid by licensed contractors. *Id.* § 444-26(c), -27.

Rev. Stat. chapter 444 and that therefore the Lums were not entitled to payment from the Fund. On August 14, 2002, the state court orally granted² the Lums' motion.

III. DISCUSSION

A. Payment from Contractors Recovery Fund.

11 U.S.C. § 362(a) provides that a petition filed in bankruptcy operates as a stay of:

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

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

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

. . . .

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

The Debtor argues that the Lums violated the automatic stay imposed by 11 U.S.C. § 362 when they moved the state court for payment from the Fund. He notes that the Lums failed to request relief from the automatic stay prior to filing their motion. The Debtor argues that the Lums' motion amounted to the continuation of a judicial action against the Debtor and the assertion of new claims in violation of section 362(a)(1), and an attempt to collect a prepetition judgment in violation of section 362(a)(2). The Debtor further argues that payment from the Fund would result in "suspension" of his contractor's license, that the license is property of his

²At the hearing in this court, the Lums' counsel said that she had refrained from submitting a proposed order to the state court until the bankruptcy court disposed of this motion.

bankruptcy estate, and that the Lums' conduct therefore violated section 362(a)(3). Finally, the Debtor argues that the Lums' motion was an "act to collect . . . or recover" a prepetition claim against the Debtor in violation of section 362(a)(6).

The Lums maintain that they did not violate the automatic stay in seeking payment from the Fund. The Lums explain that the Fund is not property of the Debtor or the bankruptcy estate which the automatic stay protects. The Lums also explain that they did not request the revocation of the Debtor's contractors license or any other disciplinary action against the Debtor.

The automatic stay under 11 U.S.C. § 362(a) "does not stay actions against guarantors, sureties, corporate affiliates, or other non-debtor parties liable on the debts of the debtor." In re Chugach Forest Products, Inc., 23 F.3d 241 (9th Cir. 1994) (automatic stay does not bar enforcement of maritime lien against vessel carrying debtor's cargo); United States v. Dos Cabezas Corp., 995 F.2d 1486, 1491-94 (9th Cir. 1993) (creditor may sue nonbankrupt cosigners of promissory note); In re Lockard, 884 F.2d 1171, 1176-79 (9th Cir. 1989) (creditor may sue nonbankrupt surety); Ingersoll-Rand Financial Corp. v. Miller Mining Co., 817 F.2d 1424, 1427 (9th Cir. 1987) (creditor may sue nonbankrupt guarantor). The Fund functions much like a guarantor or surety of certain obligations of licensed contractors. When a contractor seeks bankruptcy relief, the automatic stay does not protect the Fund.

Similarly, the automatic stay does not protect property in which neither the debtor nor the estate have an interest. The Fund is not property of the Debtor or the bankruptcy estate. Rather, the Fund is a special fund created by state statute that consists of fees paid by licensed contractors and is maintained by the CLB. See Haw. Rev. Stat. § 444-26 and Haw. Rev. Stat. § 444-29.

Therefore, the Lums' efforts to collect from the Fund did not violate the automatic stay.

B. Termination of Contractors License.

The Debtor is primarily concerned, not with whether the Lums can receive partial compensation from the Fund, but rather with whether the payment from the Fund will result in the termination of his contractor's license. The Debtor's concern is well-founded. Haw. Rev. Stat. § 444-28(e) states:

(e) The license of the contractor shall be automatically terminated upon execution of a settlement agreement requiring payment from the contractors recovery fund or the issuance of a court order authorizing payment from the contractors recovery fund. No contractor shall be eligible to receive a new license until the contractor has repaid in full, plus interest at the rate of ten per cent a year, the amount paid from the contractors recovery fund on the contractor's account. A discharge in bankruptcy shall not relieve a person from the penalties and disabilities provided in this subsection.

The Debtor argues that the termination of his license would violate 11 U.S.C. § 525, which provides:

a governmental unit may not deny, revoke, suspend, or refuse to renew a license, permit, charter, franchise, or other similar grant to, condition such a grant to, discriminate with respect to such a grant against, deny employment to, terminate the employment of, or discriminate with respect to employment against, a person that is or has been a debtor under this title or a bankrupt or a debtor under the Bankruptcy Act, or another person with whom such bankrupt or debtor has been associated, solely because such bankrupt or debtor is or has been a debtor . . . , has been insolvent before the commencement of the case . . . , or during the case but before the debtor is granted or denied a discharge, or has not paid a debt that is dischargeable in the case under this title or that was discharged under the Bankruptcy Act. (Emphasis added.)

I agree with the Debtor. The license termination and the bar on relicensing under Haw. Rev. Stat. § 444-28(e) occur automatically and solely because the licensee has failed to pay or perform an obligation that is covered by the Fund. In this case, the termination of the Debtor's

license would occur solely because the Debtor failed to pay his debt to the Lums under the state court judgment. All of the Debtor's debts to the Lums are dischargeable and were discharged on August 28, 2002. Therefore, the termination of the Debtor's contractors license and the refusal to issue a new license to the Debtor pursuant to Haw. Rev. Stat. § 444-28(e) would violate 11 U.S.C. § 525.

The CLB states that, if section 525 prohibits the CLB from requiring the Debtor to repay the Fund as a condition to renewal of his contractor's license, and if this court allows the termination of the Debtor's license under Haw. Rev. Stat. § 444-28(e), the CLB would not require the Debtor to repay the Fund as a precondition to the Debtor's application for a new contractors license, notwithstanding the second sentence of Haw. Rev. Stat. § 444-28(e). Thus, the CLB apparently concedes that the second sentence of Haw. Rev. Stat. § 444-28(e) violates section 525. As the statute is written, the automatic termination of the Debtor's license pursuant to the first sentence of Haw. Rev. Stat. § 444-28(e) also violates section 525.

The CLB argues that, apart from the automatic termination provision of Haw. Rev. Stat. § 444-28(e), there are other grounds for termination of the Debtor's contractors license. Haw. Rev. Stat. § 444-17 provides that the CLB may revoke, suspend, or refuse to renew a license for any cause, including but not limited to twenty prohibited acts. Haw. Rev. Stat. § 444-17 provides, in part:

In addition to any other actions authorized by law, the board may revoke any license issued pursuant to this section, or suspend the right of a licensee to use a license, or refuse to renew a license for any cause authorized by law, including but not limited to the following:

(3) Abandonment of any construction project or operation without reasonable or legal excuse;

....

(5) Wilful departure from, or wilful disregard of plans or specifications in any material respect without consent of the owner or the owner's duly authorized representative, that is prejudicial to a person entitled to have the construction project or operation completed in accordance with those plans and specifications;

....

(11) Failure of a licensee to complete in a material respect any construction project or operation for the agreed price if the failure is without legal excuse;

....

(13) Willful failure or refusal to prosecute a project or operation to completion with reasonable diligence

The CLB maintains that, based on the state court's findings of fact and conclusions of law, the CLB could revoke the Debtor's license based on violations of Haw. Rev. Stat. § 444-17 (3), (5), (11), and (13). The CLB believes that the termination of the Debtor's contractors license pursuant to Haw. Rev. Stat. § 444-17 would be an exercise of its police power to protect the public safety and would be excepted from the automatic stay under 11 U.S.C. § 362(b)(4). Section 362(b)(4) provides that the filing of a petition does not operate as a stay "of the commencement or continuation of an action or proceeding by a governmental unit . . . to enforce such governmental unit's or organization's police or regulatory power"

Termination of a license for cause pursuant to Haw. Rev. Stat. § 444-17 would not violate 11 U.S.C. § 525 unless the termination was based solely upon the fact that the debtor sought bankruptcy relief, obtained a discharge, or did not pay a dischargeable debt. In this case, however, all of the grounds for termination identified by the CLB relate to the Debtor's breaches of his contract with the Lums. All of the Debtor's debts to the Lums have been discharged.

Therefore, the revocation or nonrenewal of the Debtor's license as a result of those events would occur "solely" because the Debtor did not pay those dischargeable debts and would violate section 525.

NextWave Personal Communications Inc. v. Federal Communications Comm'n, 254 F.3d 130 (D.C. Cir. 2001), is instructive in this regard. NextWave was the successful bidder for certain Federal Communications Commission ("FCC") licenses. Pursuant to the applicable statute and regulations, NextWave elected to pay the bid price in installments. NextWave defaulted, filed a bankruptcy petition, and eventually proposed a plan of reorganization that provided for the delayed but full payment of the bid price. The FCC objected to the plan, contending that, by virtue of its regulations, the licenses had been canceled automatically when NextWave missed its payments. On appeal, the Court of Appeals for the D.C. Circuit held that the license cancellation had occurred "solely because" NextWave had failed to pay the bid price, a dischargeable debt, and that therefore the plain language of section 525 precluded the automatic cancellation. The FCC argued that the cancellation of the licenses constituted an exercise of its "police or regulatory power" and was excepted from the automatic stay under section 362(d)(4). The FCC went on to argue that section 525 should not be construed to prohibit an act which section 362(d)(4) permits. The Court of Appeals for the D.C. Circuit disagreed, holding (among other things) that the plain language of section 525 could not be circumvented by reference to section 362(b)(4).

Like the FCC in the NextWave case, the CLB argues vigorously against any restriction on its power to protect the public from unscrupulous contractors. Section 525 represents a congressional determination, however, that governmental units should not treat people as

unscrupulous simply because they have obtained protection under the bankruptcy laws. The courts may not second guess this legislative judgment.

The only reason that the CLB gives for terminating the Debtor's license is his failure to live up to his obligations to the Lums. Because all of those obligations have been discharged, section 525 precludes the termination of the Debtor's license on that basis.

C. Damages.

The Debtor is not entitled to either actual or punitive damages. The Lums' effort to collect a portion of the judgment from the Fund did not violate the automatic stay. The Debtor's contractors license has been effective and continues to remain in effect; therefore, there has not been a violation of section 525. To date, the Debtor has suffered no compensable harm.

IV. CONCLUSION

I will deny that portion of the Motion which seeks a determination that the Lums violated the automatic stay and an award of damages from the Lums. I will grant that portion of the Motion which seeks a determination that the automatic termination of, or refusal to renew, the Debtor's contractors license based solely upon his failure to reimburse the Fund for the amounts that the Fund will pay to the Lums, or based solely upon his non-payment of debts owed to the Lums, violates 11 U.S.C. § 525. An appropriate separate judgment will be entered.

Dated: Honolulu, Hawaii, _____.

Robert J. Faris
United States Bankruptcy Judge