PART II: ELEMENTS OF A FEDERAL NONTAX DEBT

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A. DEFINITIONS OF DEBT, DEBTOR, AND DELINQUENCY

I. INTRODUCTION

Before collecting a debt, it is essential to answer three questions: (1) Is there a debt? (2) Is it owed by a debtor? (3) Is it delinquent? The responses to these questions inform what collection actions, if any, an agency can, should, or must take. This chapter addresses the meanings of the terms "debt," "debtor," and "delinquency" in the context of nontax debt collection by federal agencies. Unless otherwise specified, these terms are defined for the purposes of federal nontax debt collection under the Debt Collection Act of 1982, Pub. L. No. 97-365, 96 Stat. 1749 (1982) (DCA) and the Debt Collection Improvement Act of 1996, Pub. L. No. 104-134, 110 Stat. 1321 (1996) (DCIA). Other laws may have different definitions of these terms.

II. WHAT IS A DEBT?

A. DEFINITION

To collect a debt, an agency must first determine that a debt exists. *See* 31 U.S.C. §§ 3701(b), 3711(a). A debt is "any amount of funds or property that has been determined by an appropriate official of the Federal Government to be owed to the United States[1] by a person, organization, or entity other than another Federal agency." *Id*. § 3701(b)(1); *accord* 31 CFR § 900.2. The terms "debt" and "claim" are often used interchangeably in federal debt collection statutes and regulations, and there is no meaningful distinction between these terms. 31 U.S.C. § 3701(b) (defining "the term 'claim' or 'debt'"); 31 CFR § 900.2(a) ("For the purposes of the standards in this chapter, the terms 'claim' and 'debt' are synonymous and interchangeable."); *see also* 49 Fed. Reg. 8889, 8889 (Mar. 9, 1984) (former Federal Claims Collection Standards (FCCS)) (confirming that there is no meaningful distinction between the terms "debt" and "claim" because the DCA uses them interchangeably). The term "debt" generally includes both current receivables and delinquent debts. *See* 31 U.S.C. § 3701.

B. TYPES OF FEDERAL DEBTS

Federal debts may arise for a variety of reasons. The categories of federal nontax debt specifically listed in 31 U.S.C. § 3701(b)(1) are not exclusive. *Id*. § 3701(b)(1); 31 CFR § 900.2(a). The categories do, however, provide examples of the ways a federal debt may come into existence. *Id.*

(1) Direct and Guaranteed Loans

> Debts may arise from "funds owed on account of loans made, insured, or guaranteed by the Government, including any deficiency or any difference between the price obtained by the

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[1] The definition of "debt" generally means an amount owed to the United States by a person other than a federal agency. *Id*. § 3701(b)(1). For certain purposes, however, this term includes amounts owed to state governments by a person other than a federal agency. For example, states may enter into reciprocal agreements with the Federal Government to use administrative offset to collect their state debts. *See id*. §§ 3701(b)(2), 3716(h) (governing the reciprocal offset program). The collection of debts owed to states is outside the scope of this *Treatise*.

Government in the sale of a property and the amount owed to the Government on a mortgage on the property." 31 U.S.C. § 3701(b)(1)(A). Loans are governed by contractual arrangements among the lender, the borrower and, if applicable, the guarantor (or other third party). Agencies must therefore understand the terms of the loan (and any applicable guarantees or repurchase rights/obligations) that apply to the debt being collected.

a) Direct Loans

Direct loans are loans made by the Government directly to a borrower.[2] Direct loans give rise to federal debts as soon as the funds are disbursed to the borrower. *See id*. § 3701(b)(1)(A). Direct loans become delinquent if a payment has not been made by the date specified in the agreement or instrument (taking into account any applicable grace period), unless the agency and borrower agree to an alternative payment arrangement. OMB CIRC. A-129 at § V.A.1.

b) Insured and Guaranteed Loans

A loan insured or guaranteed[3] by the Government originates between the borrower and a private sector lender. *See id.* at § V.A.2. "Loans guaranteed or insured by the Federal Government are in default when the borrower breaches the loan agreement with the private sector lender." *Id.* "A default *to the Federal Government* occurs when the [Government] repurchases the loan, pays a loss claim or pays reinsurance on the loan." *See id.* (emphasis added). That is, the Government is owed a debt at the time the Government repurchases the loan, pays a loss claim, or pays reinsurance on the loan. 31 U.S.C. § 3701(b)(1)(A); *Guillermety v. Sec'y of Educ.*, 241 F. Supp. 2d 727, 746 (E.D.

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[2] *See* OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, OMB CIRC. NO. A-129, POLICIES FOR FEDERAL CREDIT PROGRAMS AND NON-TAX RECEIVABLES, § II.B (revised Jan. 2013) [hereinafter OMB CIRC. A-129].

[3] Several federal statutes allow the United States to "guarantee" a borrower's performance of a loan, either by paying a loss claim to the lender upon the borrower's default, by agreeing to repurchase the loan upon the borrower's default, or by indemnifying the lender for its loss upon the borrower's default. *Id.* at § V.A.2. Agencies should pay special attention to the relevant statutes, regulations, and debt documents. The terms "guaranteed" and "insured" are not always used with precision, and the rights of the relevant parties will depend on the nature of the transaction, rather than whether it is called a "guaranteed loan," a "surety contract," or an "insured loan." As one court stated,

> The use of the word "insurance" in the statute is not determinative in light of the realities existing between the relevant parties. . . . Insurance is a contract where one undertakes to indemnify another against loss, damage or liability caused by an unknown or contingent event. Since the insured pays the insurer for the promise of indemnity, the insurer benefits to the extent that a contingency never occurs. Where a contingency does occur, the insurer can still be made whole, by virtue of subrogation, to the extent that the insured would be able to recover damages from a third party. . . . A surety, on the other hand, promises to assume the responsibility for the payment of a debt incurred by another should he or she fail to repay the creditor. The arrangement is made to induce the creditor to deal with the borrower where there might otherwise be a reluctance to do so. Under this arrangement, the nature, size, and source of the possible loss to the creditor is known from the start. In addition, there is no payment from the creditor to the surety or guarantor for this "insured" payment. Rather, a kind of tripartite relationship is formed.

United States v. Tilleraas, 709 F.2d 1088, 1091-1092 (6th Cir. 1983).

Mich. 2002) (stating that, for purposes of 31 U.S.C. § 3701, a claim does not include a guaranteed loan, until the Government pays a claim on the guarantee); *see also Tilleraas*, 709 F.2d at 1091 (noting that for statute of limitations purposes, the Government's cause of action accrued when the Government paid the private sector lender); *United States v. Frisk*, 675 F.2d 1079, 1083 (9th Cir. 1982) (same); *United States v. Baker*, 681 F. Supp. 750, 751 (M.D. Ala. 1987) (finding that the government's action could not have accrued until the date on which the bank assigned the loan to the federal agency); *but see United States v. Excellair, Inc.*, 637 F. Supp. 1377, 1395 (D. Colo. 1986) ("The sole sensible interpretation [of 31 U.S.C. § 3701] is that a loan guaranteed by the government is a 'claim of the United States' even when, at the time of transfer, the guarantee had not yet been honored.").

c) Effect of State Anti-Deficiency Law

As stated above, federal debts include "any deficiency or any difference between the price obtained by the Government in the sale of a property and the amount owed to the Government on a mortgage on the property." 31 U.S.C. § 3701(b)(1)(A).

Agencies should be aware of state laws governing collection of deficiencies, which may affect whether a deficiency is a valid and legally enforceable debt. Generally, a federal agency cannot be denied the benefits of federal law due to an election it makes under state procedural law. *See* U.S. Const. Art. VI, cl. 2; *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941) (holding, under the circumstances, that a state law was unenforceable and could not "stand[] as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress"). In other words, if Congress has legislated how and when a deficiency may be recovered, federal law applies in place of state law. *Carter v. Derwinski*, 987 F.2d 611, 615 (9th Cir. 1993) ("Federal law is mandatory, and neither the State of Idaho through legislation, nor the VA through its litigation choices, can waive its applicability.").

When federal law does not expressly address an agency's right to collect deficiency, the agency must look to the analysis set forth in *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 726-27 (1979). In *Kimbell*, the Supreme Court identified three factors relevant to determining whether state law applies to liens arising from federal programs: (1) whether the federal program at issue requires uniform federal rules; (2) whether adopting state substantive law would frustrate federal program objectives; and (3) the extent that a uniform federal rule would disrupt normal commercial relationships. *Id.* The Supreme Court also noted that "[a]dopting state law as an appropriate federal rule does not preclude federal courts from excepting local laws that prejudice federal interests." *Id.* at 736 n.37; *see also United States v. Jacobsen*, 319 F.3d 323, 323-24 (8th Cir. 2002) (per curiam) (holding that a federal law required an agency to adopt certain state procedural rules, but not state substantive rules, and a debtor's right to protection from deficiency judgments constituted a substantive rule); *Derwinski*, 987 F.2d at 615-17 ("State laws which affect lenders' ability to recapture additional amounts from [debtors] after foreclosure . . . do not affect the [agency's] independent right to seek recovery . . . ."); *Chi. Title Ins. Co. v. Sherred Vill. Assoc.*, 708 F.2d 804, 806 (1st Cir. 1983) (following *Kimbell* and finding that in the absence of a federal statute setting priorities and seeing no need for a uniform federal rule, a state law granting a mechanic's lien priority over a later-assigned federal mortgage should apply); *United States v. Victory Highway Vill., Inc.*, 662 F.2d 488, 497 (8th Cir. 1981) ("[B]ecause of 'an overriding federal interest in protecting the funds of the United States and in securing federal investments,' federal interest predominates over state interest." (quoting *United States v. Scholnick*, 606 F.2d 160, 164 (6th Cir. 1979)); *Resolution Tr. Co. v. Johnson*, 844 F. Supp. 535, 537 (D. Minn. 1992) (rejecting state statutory redemption requirement because federal law controls when the Federal Government is foreclosing on a lien).

(2) Expenditures of Nonappropriated Funds

Debts may also arise from "expenditures of nonappropriated funds, including actual and administrative costs related to shoplifting, theft detection, and theft prevention." 31 U.S.C. § 3701(b)(1)(B). A 2001 amendment to 31 U.S.C. § 3701 added "including actual and administrative costs related to shoplifting, theft detection, and theft prevention" in the context of a series of enactments related to military commissaries. Pub. L. No. 107-107, Div. A, Title III, Subtitle C, § 335, 115 Stat. 1060 (Dec. 28, 2001). The Army and Air Force Exchange Service (AAFES) has a policy of charging every apprehended shoplifter for the cost of any stolen property, plus a flat rate administrative cost associated with the cost of shoplifting. AAFES SHOPLIFTING POLICY, https://www.7atc.army.mil/Portals/17/Documents/SJA/AAFESShopliftingPolicy.pdf. The program aims to deter shoplifters by adding an extra amount above the cost of the stolen items and to reimburse the Government for the general costs incurred due to shoplifting. *Id.*; *see also United States v. Santosdedios*, 240 F. Supp. 2d 414, 422 (D. Md. 2002) (noting that "[t]he AAFES civil recovery program was instituted to recoup non-appropriated funds" and holding that an administrative charge to the debtor of $200 was not sufficiently extreme to transform that civil penalty into a criminal penalty giving rise to double jeopardy when the debtor was also criminally prosecuted for shoplifting). Similarly, the Coast Guard has implemented the Nonappropriated Fund Instrumentalities Civil Recovery Program for the same purpose. *See* U.S. DEPT. OF HOMELAND SEC., U.S. COAST GUARD, NONAPPROPRIATED FUND INSTRUMENTALITIES MANUAL, COMDTINST M7010.5D (Jul. 2022), *available at* https://media.defense.gov/2022/Aug/02/2003047918/-1/-1/0/CI_7010_5D.PDF.

(3) Overpayments

Debts may also arise as a result of "over-payments, including payments disallowed by audits performed by the Inspector General of the agency administering the program." 31 U.S.C. § 3701(b)(1)(C). Overpayments are payments issued to the wrong person or in an incorrect amount, whether caused by agency error, or mistake or fraud by the payee. *See Blanca Tel. Co. v. FCC*, 991 F.3d 1097, 1114 (10th Cir. 2021) (stating that the DCIA defines "claim" expansively and finding the debt at issue constituted an overpayment); EXEC. ORD. NO. 13520, REDUCING IMPROPER PAYMENTS (Nov. 20, 2009) ("The purpose of this order is to reduce improper payments by intensifying efforts to eliminate payment error, waste, fraud, and abuse in the major programs administered by the Federal Government . . . ."); Payment Integrity Information Act of 2019, Pub. L. 116–117, § 1 (Mar. 2, 2022) (defining "improper payment" as "any payment that should not have been made or that was made in an incorrect amount, including an overpayment. . ."). Regardless of the cause of the overpayment, agencies must attempt to collect these debts. *See, e.g.*, *United States v. Wurts*, 303 U.S. 414, 415, 58 S. Ct. 637, 638 (1938) ("Government by appropriate action can recover funds which its agents have wrongfully, erroneously, or illegally paid" and this right "is independent of statute"); *United States v. Burchard*, 125 U.S. 176, 181 (1888) (affirming the Navy's right to collect an overpayment made by disbursing officers to a retired officer); *Agility Pub. Warehousing Co. K.S.C.P. v. United States*, 969 F.3d 1355, 1365 (Fed. Cir. 2020) ("the United States has an independent and inherent right to recover erroneously expended congressionally appropriated funds"); *Old Republic v. Fed. Crop Ins. Corp.*, 947 F.2d 269, 272, 275 (7th Cir. 1991) (holding that agencies have authority under contract, statute, and common law to recoup overpayments that result from agency error); *Square One Armoring Servs. Co. v. United States*, 162 Fed. Cl. 331, 339 (2022) (finding that the Government may take appropriate action to recover amounts that have been wrongfully, erroneously, or illegally paid); *Lawrence v. United States*, 69 Fed. Cl. 550, 552 (Fed. Cl. 2006) (holding that the Government was entitled to collect after it erroneously overpaid an employee's Living Quarters Allowance by $53,762.07); *Bank One v. United States*, 62 Fed. Cl. 474, 475 (Fed. Cl. 2003) ("The government's right to recover payments made by mistake is rooted both in the Constitution of the United States and in the Anti-Deficiency Act, and is well established in case law. This money belongs to the people and taxpayers of the United States"). Even if the agency does not become aware of the overpayment for many years, the agency generally must attempt to collect the debt when it discovers the overpayment. *See Brumley v. United States*, 55 Fed. Cl. 431, 432-33 (Fed. Cl. 2003) (finding that collection of overpayments made under the Federal Employees Compensation Act was permissible even though the Government became aware of the overpayments in 1983 but did not move to collect until 1991).

(4) Unpaid Share of Non-Federal Partner in Program Involving Federal Payment and Matching/Cost-Sharing Payment by Non-Federal Partner

Federal debt can also result from "the unpaid share of any non-federal partner in a program involving a federal payment and a matching, or cost-sharing, payment by the non-federal partner." 31 U.S.C. § 3701(b)(1)(E). Agencies must collect debts from non-federal partners, such as states, who do not meet their contractual obligations arising from a payment-sharing agreement with the Federal Government. *See Gallegos v. Lyng*, 891 F.2d 788, 789 (10th Cir. 1989) (acknowledging that a state participant in a food stamp cost-sharing program owed a federal debt when an unacceptable number of food stamps were lost in the mail, because the state accepted liability for lost stamps as part of its participation in the program).

(5) Fines and Penalties

Federal debts also arise from "any fines or penalties assessed by an agency." 31 U.S.C. § 3701(b)(1)(F); *see United States v. Collins*, 36 F.4th 487, 495 (3d Cir. 2022) (finding that the civil penalties imposed under the Bank Secrecy Act constituted a "fine or penalty" under the Federal Claims Collection Act); *Blanca Tel. Co.*, 991 F.3d at 1112 (discussing whether a debt was a penalty or an overpayment and concluding it was an overpayment). In this context, "penalty" refers to the debt itself, and not to the "penalty" assessed pursuant to 31 U.S.C. § 3717 for failure to pay a debt on time. However, interest, administrative costs, and penalties assessed on delinquent debts are also "debts" for purposes of 31 U.S.C. § 3701(b).

(6) Other Debts

As noted above, the listing of debts in 31 U.S.C. § 3701(b)(1) is non-exclusive and is not meant to be an exhaustive description of the types of debts that may be owed to the United States. *See* 31 U.S.C. § 3701(b)(1)(G) (including "other amounts of money or property owed to the Government" in the definition of "debt"). Thus, "any amount of funds or property that has been determined by an appropriate official of the Federal Government to be owed to the United States," other than a debt owed by a federal agency, is a debt for purposes of chapter 37 of title 31 of the United States Code. *Id*. § 3701(b).

C. SPECIAL CLASSES OF DEBT

(1) Debts Arising Under the Internal Revenue Code, Social Security Act, and Tariff Laws

There are limits on the applicability of some debt collection tools for certain classes of debts. *Id*. § 3701(d). Specifically, sections 3711(e) (consumer credit reporting), 3716 (administrative offset), 3717 (interest, costs, and penalties), 3718 (private collection contractors), and 3719 (reporting on debt collection activities) of title 31 of the United States Code do not apply to debts arising under the Internal Revenue Code, the Social Security Act (with various exceptions), or the tariff laws of the United States. *Id.*; *see also* 31 CFR § 900.3. While these classes of debt are exempt from certain debt collection schemes, they may be subject to collection under other laws.

(2) Debts Arising From Fraud, Antitrust Violations, False Claims, or Misrepresentation

Upon identification of a claim that, in whole or in part, involves fraud, antitrust violations, false claims, or misrepresentation, agencies should promptly notify the Department of Justice (DOJ) for appropriate action. 31 CFR § 900.3(a).[4] Only DOJ has the authority to compromise or suspend or terminate debt collection action on such claims. *Id.*; *see also* 31 U.S.C. § 3711(b)(1). At its discretion, DOJ may return the claim to the appropriate agency for further handling in accordance with the FCCS. 31 CFR § 900.3(a).

[4] Agencies with independent litigating authority do not need to refer these debts to DOJ if the scope of their authority includes these types of debts.

D. ESTABLISHING DEBTS

(1) Agency Regulations Defining Debt

Agencies must issue debt collection regulations. 31 U.S.C. §§ 3711(d), 3716(b); *see also id*. §§ 3717(h); 3720D(c)(1). Agencies must also attempt to collect debts. *Id*. § 3711(a); 31 CFR § 901.1. As such, agencies must ensure that their regulations support collection of all debts that may arise. *See* 31 U.S.C. §§ 3711(d), 3716(b); *see also id*. §§ 3717(h); 3720D(c)(1). In other words, if defining the term "debt" in their regulations, agencies should either adopt the statutory definition codified in 31 U.S.C. § 3701(b) or should ensure that their definition does not unintentionally narrow their ability to collect amounts owed.

(2) Agency Determination

An appropriate agency official must establish the existence of a debt. *Id*. § 3701(b)(1). An "appropriate official" is generally a person with a level of expertise necessary for understanding the debt. Agency employees who establish debts should have relevant training and/or experience. The level of expertise required will vary depending on the size and type of debt with which they work. Thus, who constitutes an appropriate official to establish a debt is context dependent.

(3) General Procedures for Establishing Debt

Agency procedures for establishing debts vary, just as the types of debts owed to different agencies vary. Generally, agencies do not have to go to court or rely on specific statutory authority to establish a debt; a federal nontax debt exists merely because an agency determines that it exists.[5] Agencies must establish debts even if those debts could not be enforced in court because a statute of limitations bars the creditor agency from pursuing judicial remedies. *See, e.g.*, *United States v. Moriarty*, 8 F.3d 329, 334 (6th Cir. 1993) ("[A]lthough the United States may be precluded by the applicable statute of limitations from

[5] *Id*. § 3701(b)(1); *see also Bell v. New Jersey*, 461 U.S. 773, 775 (1983) (holding that the Secretary of Education could administratively determine the amount of a debt associated with collecting funds that had been misapplied by certain states); *Collins*, 36 F.4th at 496 ("debt is no less a claim of the United States simply because the Government has sued to collect and a court confirms that it is owed"); *McCall Stock Farms v. United States*, 14 F.3d 1562, 1570 (Fed. Cir. 1993) (the "argument that mediation or direct suit must precede use of an administrative offset has no basis in statute or regulation."); *Lawrence v. Commodity Futures Trading Com.*, 759 F.2d 767, 772 (9th Cir. 1985) (finding "a Congressional mandate that agencies play a more active role in the collection of delinquent claims than merely referring them to the Department of Justice"); *Di Silvestro v. United States*, 405 F.2d 150, 155 (2d Cir. 1968) ("It is, of course, well established that parties receiving monies from the Government under a mistake of fact or law are liable *ex aequo et bono* to refund them, and that no specific statutory authorization upon which to base a claimed right of set-off or an affirmative action for the recovery of these monies is necessary."); *Cleveland v. United States*, No. 3:13-CV-281, 2020 U.S. Dist. LEXIS 123356, at *7 (M.D. Pa. July 13, 2020) (the regulatory framework provided for the Treasury Offset Program provides ample guidance for agencies to protect a debtor's due process without the need for a court order); *United States v. Beulke*, 892 F. Supp. 2d 1176, 1187 (D.S.D. 2012) (finding that a court order is not a prerequisite to collection through offset"); *Red River Farms v. United States*, No. 08-2078, 2009 U.S. Dist. LEXIS 85576, at *9 (D. Ariz. Sept. 16, 2009) ("there is no requirement that the Government sue Red River before it resorts to administrative offset"); *Ingram v. Cuomo*, 51 F. Supp. 2d 667, 672 (M.D.N.C. 1999) ("[A] deficiency judgment is not required in order for the debt to be 'legally enforceable' and subject to the tax offsetting provisions of 31 U.S.C. § 3720A.").

bringing an action for money damages, it continues to have a 'right to payment' against the debtor in this case and thus may enforce that right in other ways."). However, a debtor does have a right to contest an agency's determination that a debt exists. *See, e.g.*, 31 U.S.C. §§ 3711(e)(2) (granting debtors a right to request reconsideration of a debt before the agency reports the debt to a consumer reporting agency), 3716(a)(3) (providing that an agency may only collect a debt through administrative offset if it has provided the debtor with an opportunity for review of the agency's decision), 3720D(b)(5) (providing debtors with a right to request a hearing on the existence and amount of the debt, or on the terms of a repayment schedule, when administrative wage garnishment will be used as a collection tool); *see also* 5 U.S.C. § 702 (describing a person's right to seek judicial review of agency actions).

(4) Establishing Estimated Debts

If the exact amount of a claim is unknown, but an agency can make a reasonable estimate of the claim, the agency should begin collection activity based on its estimate.[6] As explained in a Comptroller General opinion:[7]

> [T]he government may set off the estimated amounts of its claims . . . and may do so even in the absence of final resolution of the underlying dispute . . . . The use of this method of collection is not conditioned on whether the claim arose out of contract or otherwise.

Chandler Trailer Convoy, Inc., B-193432, B-211194, 1984 U.S. Comp. Gen. LEXIS 1737 (Comp. Gen. Jan. 5, 1984).[8]

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[6] *See Dominion Ambulance, L.L.C. v. Azar*, 968 F.3d 429, 440 (5th Cir. 2020) (acknowledging that requiring the individual audit of each claim would likely make it impossible for the agency to meaningfully audit its program); *United States v. Lahey Clinic Hosp., Inc.*, 399 F.3d 1, 18 n.19 (1st Cir. 2005) (stating that the "sampling of similar claims and extrapolation from the sample is a recognized method of proof"); *Ratanasen v. Cal., Dep't of Health Servs.*, 11 F.3d 1467, 1468 (9th Cir. 1993) (holding, in an appeal of a bankruptcy case, that "the use of sampling and extrapolation as part of audits" is an appropriate way to establish a debt, "provided the aggrieved party has an opportunity to rebut such evidence"); *Chaves Cty. Home Health Serv., Inc. v. Sullivan*, 931 F.2d 914, 919 (D.C. Cir. 1991) (noting that statistical sampling is routinely permitted where case-by-case review would be too costly); *Mich. Dep't of Educ. v. U.S. Dep't of Educ.*, 875 F.2d 1196, 1205 (6th Cir. 1989) (finding that an "audit of the thousands of cases comprising the universe of cases would be impossible" and that the United States could, therefore, determine the amount of the overpayment through statistical sampling); *Ill. Physicians Union v. Miller*, 675 F.2d 151, 156 (7th Cir. 1982) ("[T]he use of sampling and extrapolation is proper provided there is an opportunity to rebut the initial determination of overpayment . . . .").

[7] Opinions of the Comptroller General are not binding on federal agencies in the debt collection context. *See* General Accounting Office Act of 1996, Pub. L. 104-316, § 115(g), 110 Stat. 3826, 3835; Admin. Settlement of Disputes Concerning Determinations of Mineral Royalties Due the Gov't, 1998 OLC LEXIS 32, at *13 n.7 (July 28, 1998) ("Although the opinions and legal interpretations of the GAO and Comptroller General often provide helpful guidance . . . they are not binding upon departments, agencies, or officers of the executive branch."). *See generally Bowsher v. Synar*, 478 U.S. 714 (1986).

[8] *See also Alan I. Saltman*, B-259532, 1995 WL 905738, at *4 (Comp. Gen. Mar. 6, 1995) (finding that estimates based on valid presumptions and made by appropriate administrative officials are enough to justify offsets); *Metro Machine Corp.*, B-187178, 1976 U.S. Comp. Gen. LEXIS 1966, at *2 (Comp. Gen. Oct. 7, 1976) ("The Government is permitted to set off the estimated amount of claims due the United States by withholding amounts due under Government contracts."); *Frank Briscoe Co.*, B-161283, 1976 U.S. Comp. Gen. LEXIS 2818, at *2-3 (Comp. Gen. Mar. 16, 1976) (rejecting the argument that it was premature to declare the company a debtor and holding that the agency could initiate collection action for estimated debts that arose out of a contract); *Gesford P. Wright*, B-

(5) Establishing Tort Debts

As with any other debt, an agency may establish a tort debt without going to court. *See generally Red River Farms v. United States*, No. 08-2078, 2009 U.S. Dist. LEXIS 85576, at *9 (D. Ariz. Sept. 16, 2009) (finding that the U.S. Coast Guard's National Pollution Fund Center was authorized to establish and use administrative offset to collect a debt related to oil spill cleanup costs). In some circumstances, tort damages evaluations may require considerable legal or technical expertise. Each agency should ensure that its agency officials who establish tort debts are knowledgeable about the factors that will affect the debt determination.

(6) Establishing Contract Debts

Debts owed to the United States may arise when an agency contracts with a person for a good or service, and the other person breaches or fails to perform all or some portion of the contract. Before commencing collection activity, agencies should determine how their debt collection authority interacts with the Contract Disputes Act of 1978 (CDA). *See* Pub. L. 95-563, 92 Stat. 2383 (now codified at 41 U.S.C. §§ 7101-09). The CDA sets forth procedures for handling claims related to government contracts, whether the claims are against the Government or against the contractor. *Id.*; *Cecile Indus., Inc. v. Cheney*, 995 F.2d 1052, 1055 (Fed. Cir. 1993) ("The CDA clearly and comprehensively defines the procedures for all contractual disputes between the United States and private contractors."). The administration of a contract is under the jurisdiction of the relevant contracting agency and, consistent with other debts, the agency does not need to seek a judicial determination of the amount of money owed to it. *See Wright*, 1972 U.S. Comp. Gen. LEXIS 1884, at *3.

The CDA—rather than the DCA and DCIA—generally governs the collection of debts arising under a contract through offset of payments owed by the United States under the same contract. *See Cecile Indus.*, 995 F.2d at 1055 (holding that offset of claims from a single contract is not governed by the DCA); *Allied Signal, Inc. v. United States*, 941 F.2d 1194, 1198 (Fed. Cir. 1991) (finding that no "debt" existed under the DCA when an agency sought to reduce payments as part of a reduction in the contract price in accordance with the CDA); *Spectrum Leasing Corp. v. United States*, 764 F.2d 891, 894 (D.C. Cir. 1985) ("The right to these payments is created in the first instance by the contract, not by the [DCA]. The DCA, even if it applied, confers no such right in the absence of the contract itself."); *Avco Corp. v. United States*, 10 Cl. Ct. 665, 666 (1986) (stating that no "debt" as contemplated by

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176791, 1972 U.S. Comp. Gen. LEXIS 1884, at *3 (Comp. Gen. Sept. 8, 1972) ("Where the amount due the Government had not been finalized under the procedures provided by the contract, we sanctioned the unilateral deduction of the amount estimated by the Government to be due."); *but see Nw. Airlines, Inc.*, B-210600, 1984 U.S. Comp. Gen. LEXIS 530, at *6-7 (Sept. 18, 1984) (interpreting a prior version of the FCCS and holding that a claim against one airline based only on the experience of other airlines is too uncertain for offset purposes); *Artech Corp.*, 56 Comp. Gen. 963 (Sept. 21, 1977) (finding that random sampling for purposes of projecting the full amount of an overpayment was not sufficiently certain to warrant offset (citing 4 CFR § 102.3(a) (former version of the FCCS))). The Government's right to commence collection on estimated debts is needed to "protect its rights as a creditor." *Frank Briscoe Co.*, 1976 U.S. Comp. Gen. LEXIS 2818, at *4.

the DCA existed when an agency withheld payment under the contract because it was dissatisfied with a contractor's performance). As one court explained:

> The CDA clearly and comprehensively defines the procedures for all contractual disputes between the United States and private contractors. In the absence of a statutory direction, this court is reluctant to construe the DCA to inject 'a new procedural matrix [in]to every contract.'

Cecile Indus., 995 F.2d at 1055 (alteration in original) (quoting *Avco Corp.*, 10 Cl. Ct. at 667). Thus, a "debt" does not exist under the DCA until the contract price is fixed.

The term "debt," as used in the DCA, "contemplates an existing liability by the contractor, rather than a denial of further liability by the Government within an on-going contract." *Allied Signal*, 941 F.2d at 1198. Therefore, the Court of Federal Claims concluded:

> to the extent that the DCA applies to the collection of interest, it applies only to "outstanding" debts. In order for a debt to be outstanding for the purposes of the DCA, there must first exist some amount due. In this case, the individual contracts determine when an amount becomes due. Until such amounts become due under the contracts, no "outstanding debts" exist for the purposes of the DCA.

Precision Pine & Timber, Inc. v. United States, 75 Fed. Cl. 80, 88 (2006). Thus, once an agency determines that an amount is due, it must establish and collect that debt. *See* 31 U.S.C. §§ 3701, 3711.

III. WHO IS A DEBTOR?

A. DEFINITION

Under federal nontax debt collection laws, a debtor is any legal entity other than a federal agency,[9] including individuals, corporations, partnerships, guarantors of loans, and state and municipal governments. *See id.* § 3701(b)(1). Once a person owes a debt, the person is a debtor within the meaning of federal debt collection laws. *See id.*

[9] The phrase "executive, judicial, or legislative agency" is defined by 31 U.S.C. § 3701(a)(4) as "a department, agency, court, court administrative office, or instrumentality in the executive, judicial, or legislative branch of Government, including government corporations." Resolution of interagency claims is governed by Executive Order No. 12,146. EXEC. ORD. NO. 12146, MANAGEMENT OF FEDERAL LEGAL RESOURCES (July 18, 1979) ("Whenever two or more Executive agencies are unable to resolve a legal dispute between them . . . each agency is encouraged to submit the dispute to the Attorney General."); *see also* 31 CFR § 900.3(c) (providing that the Federal Claims Collection Standards do not apply to interagency claims).

B. CERTAIN TYPES OF DEBTORS

(1) States, Localities, and Domestic and Foreign Sovereigns

State and local governments can be "debtors" for federal debt collection purposes. *Id.*; 31 CFR § 285.2.[10] Similarly, foreign and domestic sovereigns are also included within the meaning of "debtor." However, collection from foreign sovereigns is also governed by international law, other federal statutes, and related federal policies. Because this collection activity can have important foreign policy implications, agencies should consider the legal and practical limits on their collection activities in this context. Whether the sovereign will be immune from suit, for example, will depend on a variety of factors, including whether the sovereign consented (either explicitly or implicitly) to be sued, whether the United States has waived its own sovereign immunity in similar cases, the impact the suit would have on foreign relations, and whether the sovereign is acting in its capacity as a sovereign or in a commercial capacity. Agencies should consult their legal counsel to determine whether and to what extent collection action is appropriate, especially in the context of foreign sovereigns.

(2) Representatives of Debtors' Trusts and Estates

A representative of a person or an estate may become liable to the United States if the representative fails to pay the United States before paying the claims of other creditors. 31 U.S.C. § 3713(b). For a discussion of the statute providing priority for federal claims, see chapter B, below.

C. JOINT AND SEVERAL LIABILITY

Two or more debtors can be held individually liable for the same federal nontax debt. Where debtors are jointly and severally liable, *each* debtor is liable for the entire amount, even though the creditor collects the entire amount only once. The Government can pursue collection against all joint and several debtors "separately, or all of them together, at [its] option."[11]

A compromise with one debtor does not release an agency's claim against any co-debtor. 31 CFR § 902.4(b). Likewise, if the Government enters into a compromise agreement with one debtor, the compromise is not determinative of the amount required of co-debtors. *Id.* Agencies should not attempt to allocate the burden between co-debtors but should instead pursue

[10] The DCIA changed the definition of "person" for the purposes of sections 3716 and 3717 of title 31. Prior to the DCIA, the term "person" excluded "an agency of the United States Government, of a State government, or of a unit of general local government." 31 U.S.C. § 3701. The DCIA's definition of person, however, excludes only "an agency of the United States Government." *Id.*

[11] *SEC v. J.W. Barclay & Co.*, 442 F.3d 834, 843 (3d Cir. 2006); *see also* 31 CFR § 902.4(a); *Golden v. Golden*, 382 F.3d 348, 355 n.5 (3d Cir. 2004), *superseded on other grounds by Marshall v. Marshall*, 547 U.S. 293 (2006); *United States v. Gregg*, 226 F.3d 253, 260 (3d Cir. 2000); *Resolution Mgmt. Consultants v. Hickey*, 2011 U.S. Dist. LEXIS 70928, at *18-19 (D.N.J. June 29, 2011) (holding, in a case between private litigants, that the existence of joint and several liability between two persons does not require the creditor to sue both parties in the same action); *World Entm't, Inc. v. Brown*, 2011 U.S. Dist. LEXIS 55182 (E.D. Pa. May 20, 2011) (noting, in a case between private litigants, that "[l]iability is joint and several when the plaintiff may recover from one or more of the parties to such liability separately, or all of them together." (quoting *Gregg*, 226 F.3d at 260)).

collection activity against all debtors. *Id.*; *Jean Harris*, B-194383, 58 Comp. Gen. 778, 782 (Sept. 11, 1979). However, if the Government chooses to pursue collection action against only one debtor, the Government does not release its claim against the other debtor(s). *See* 31 CFR § 902.4(b).

IV. WHAT IS DELINQUENCY?

A. GENERAL DEFINITION

A debt becomes "delinquent" when the debt "has not been paid by the date specified in [an] agency's initial written demand for payment or applicable agreement or instrument." *Id.* § 900.2(b). Delinquency is defined broadly in the FCCS because the FCCS apply to a wide range of agencies and programs. 65 Fed. Reg. 70390, 70391 (Nov. 22, 2000); OMB CIRC. A-129 at § V. "Delinquency," however, may be defined differently for different purposes. For example, in the context of barring delinquent debtors from obtaining federal loans, loan insurance, or guarantees under 31 U.S.C. § 3720B, "delinquency status" is defined as 90 days late. 31 CFR § 285.13(d)(1).

B. CONSEQUENCES OF DELINQUENCY

Agencies must distinguish between current and delinquent debts. Most of the debt collection procedures described in this *Treatise* are appropriate only when a debt is delinquent. *See, e.g.*, *Precision Pine & Timber, Inc.*, 75 Fed. Cl. at 97-98 (noting, for the purpose of interest collection under the Debt Collection Act, "debt" means "delinquent debt"); *Guillermety*, 241 F. Supp. 2d at 731 (stating that an outstanding claim under 31 U.S.C. § 3716 only accrues when the Government has a "right to collect" the money owed). While the debt is current, the United States generally has no additional right to collect the money owed, and the use of adverse debt collection tools is generally inappropriate. Once the debt becomes delinquent, however, agencies should make use of such tools, including credit bureau reporting, administrative and tax refund offset, administrative wage garnishment, and referral to private collection contractors. 31 U.S.C. §§ 3711(e); 3716(c)(6); 3718; 3720A(a); 3720D. Agencies generally must also start accruing interest, penalties, and costs from the date of delinquency. *Id*. § 3717; 31 CFR § 900.9. Moreover, federal agencies are generally prohibited from providing financial assistance to delinquent debtors. 31 U.S.C. § 3720B; 31 CFR § 285.13.

C. DELINQUENCY BY DEBT TYPE

(1) Administrative Debt

Administrative debt generally becomes delinquent if and when the debtor does not pay the debt by the date specified in the agency's initial written demand for payment. *E.g.*, 31 CFR §§ 285.5(b); 285.12(a); 900.2; *see* OMB CIRC. A-129 at § V.A.3. Typically, an agency will demand payment within 30 days of the date the agency mails a notice to the debtor specifying that money is owed. 31 U.S.C. § 3717(a), (d) (generally requiring interest on a claim not paid within 30 days); 31 CFR §§ 901.2 (generally requiring agencies to requirement payment within 30 days), 901.9(g) (generally requiring interest to be paid on any debt more than 30 days delinquent). The debt is due as of the date of the agency's notice. However, agencies generally must provide a 30-day grace period for debtors to make payment before they assess interest and administrative costs or use other adverse debt collection tools. *See Id*. §§ 901.2, 901.9(g). If payment is not received within 30 days, the debt is delinquent as of the date that the original notice was mailed. *See id*. §§ 901.2; 901.9. For example, if an agency mails a letter on September 1 to a debtor informing him of a debt and demanding payment by October 1, the debtor must pay the debt by October 1. If the debtor fails to pay the debt by October 1, the date of delinquency is September 1, and interest, administrative costs, and penalties will accrue from September 1.

Like other types of administrative debt, overpayments are generally not delinquent until after an agency makes a demand for payment, even if this demand is made a long time after the overpayment. *See Brumley*, 55 Fed. Cl. at 432-33 (holding that collection of overpayments was permissible even though the Government became aware of the overpayments in 1983 but did not move to collect until 1991).

(2) Direct Loans

A direct loan becomes delinquent if a payment has not been made by the date specified in the agreement or instrument (including a post-delinquency payment agreement), unless other satisfactory payment arrangements have been made. *E.g.*, 31 CFR §§ 285.5(b); 285.12(a); 900.2(b); OMB CIRC. A-129 at § V.A. The loan agreement may include a grace period and, if payment is received during the grace period, the agency may not be able to assess interest, costs, or penalties, or use adverse debt collection tools. 31 CFR § 900.2(b). However, if a debtor does not submit payment by the end of the grace period, the date of delinquency will be the date on which the original payment was due. *Id.* An agency that intends to collect payments in regular installments generally should include an acceleration clause in the contract, under which the entire remaining balance of the loan becomes due if a debtor misses an installment payment. *Id*. § 901.8. Agencies may reach alternative payment agreements with the debtor instead of declaring the loan delinquent and beginning adverse collection procedures. OMB CIRC. A-129 at § V.

(3) Guaranteed Loans

A loan insured or guaranteed by the Government becomes a delinquent federal debt when the Government "repurchases the loan, pays a loss claim or pays reinsurance on the loan" after the borrower breaches the loan agreement with the private sector lender. *See* 31 U.S.C. § 3701(b)(1)(A); *Guillermety*, 241 F. S.upp. 2d at 746; OMB CIRC. A-129 at § V.A.2. The date of the delinquency, however, is the original due date to the private lender for the missed payment, unless the debtor enters into a new payment agreement with the third-party lender or the Government. *E.g.*, 31 CFR §§ 285.5(b); 285.12(a); 900.2(b); OMB CIRC. A-129 at § V.

(4) Repayment Agreements

If a debtor exercises its right to enter into a written agreement to repay a claim as part of the debtor's due process rights, the corresponding debt generally becomes "current" for as long as the debtor makes payments to the agency in accordance with the terms of the agreement. However, a repayment agreement becomes delinquent if a payment has not been made by the due date specified for that payment in the agreement. Generally, repayment agreements should include an acceleration clause through which one missed payment will result in the entire amount of debt becoming due immediately. Repayment agreements that do not avoid or cure the delinquency do not cause the debt to become "current."

D. AVOIDING OR CURING DELINQUENCY

Debtors may be able to avoid or cure a delinquency. Debtors can generally cure a delinquency by entering into a repayment agreement as part of their due process rights, or by making all overdue payments and paying all assessed interest, penalties, and administrative costs. *See, e.g.*, 31 CFR § 285.13(e)(1)(iii). Prior to using most debt collection tools, an agency must consider a debtor's request for a reasonable repayment agreement. *E.g.*, 31 U.S.C. §§ 3711(e)(1)(D)(i) (credit bureau reporting); 3716(a)(4) (administrative offset); 3720D(b)(4) (administrative wage garnishment). Also, in the context of loan debts, the loan agreement or applicable statute may provide a debtor with additional opportunities to cure or avoid delinquency.

B. FEDERAL PRIORITY STATUTE

I. FEDERAL DEBTS HAVE PRIORITY OVER OTHER DEBTS

Claims[12] owed to the United States have priority over claims owed to other creditors and, when a person is insolvent, federal claims must be satisfied first. 31 U.S.C. § 3713. This statutory right of priority has roots in the common law and should be interpreted broadly in favor of the United States.[13] As the Supreme Court explained:

> The right of priority of payment of debts due to the government is a prerogative of the crown well known to the common law. It is founded not so much upon any personal advantage to the sovereign, as upon motives of public policy, in order to secure an adequate revenue to sustain the public burthens and discharge the public debts. . . . and as that policy has mainly a reference to the public good, there is no reason for giving to them a strict and narrow interpretation.[14]

To protect its right to priority, a federal agency should promptly notify the debtor (or debtor's representative) of its claim, if appropriate.

II. SCOPE OF PRIORITY

A. FEDERAL DEBTS

For purposes of 31 U.S.C. § 3713, a "claim of the United States Government" includes any federal debt, whether current or delinquent, matured or unmatured, liquidated or unliquidated, tax or nontax.[15] That is, a "claim" for purposes of 31 U.S.C. § 3713 is broader than a "claim" as defined in 31 U.S.C. § 3701(b), because it includes amounts that have not yet "been determined [to be due] by an appropriate official of the Federal Government." 31 U.S.C. § 3701(b).

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[12] The Federal Priority Statute applies broadly to all kinds of claims, not only those that are included within the 31 U.S.C. § 3701's definition of "debt" or "claim."

[13] The provisions of the Federal Priority Statute have been in force without significant modification since 1797. *United States v. Emory*, 314 U.S. 423, 428 (1941); *see also United States v. Estate of Estate of Romani*, 523 U.S. 517, 524-25 (1998); *United States v. State Bank of N.C.*, 31 U.S. 29, 35 (1832); *United States v. McNicol*, 829 F.3d 77, 81 (1st Cir. 2016); *United States v. Coppola*, No. CV-88-3456, 1994 U.S. Dist. LEXIS 16848, at *25 (E.D.N.Y. Nov. 17, 1994).

[14] *State Bank of N.C.*, 31 U.S. at 35 (interpreting a precursor to 31 U.S.C. § 3713).

[15] *Id.* at 38 (finding that priority must be accorded to debts regardless of whether matured or unmatured); *Viles v. Comm'r*, 233 F.2d 376, 379-80 (6th Cir. 1956) (finding, under a precursor to 31 U.S.C. § 3717, that priority must be accorded even if the tax debt had not been formally assessed and liquidated); *United States v. Snyder*, 207 F. Supp. 189, 191 (E.D. Pa. 1962) (holding that the United States could recover overpayments of annuity made to decedent even though the United States failed to appear in or become a party to the proceedings for distribution of the debtor's estate); *United States v. Renda*, 709 F.3d 472, 479 n.4 (5th Cir. 2013) (stating that a claim of the "United States Government" incudes claims made by agencies as well as authorized representatives of agencies, regardless of whether the claim is filed in the name of the United States or in the name of the officer or agency).

B. APPLICABILITY OF STATE LAW

Federal law pre-empts inconsistent state law.[16] Consequently, state statutes of limitation do not apply to the United States, and state law cannot invalidate a claim of the United States.[17] Therefore, a delay by the United States in enforcing its right to collect a debt will not necessarily extinguish its right to make the collection.[18]

C. EXCEPTIONS TO PRIORITY

There are some exceptions to the rule that federal claims are to be given priority over other creditor's claims. This priority, for example, does not apply to claims subject to a bankruptcy proceeding filed under title 11 of the United States Code. 31 U.S.C. § 3713(a)(2).[19]

In addition, although 31 U.S.C. § 3713 does not explicitly provide for any other exceptions to the priority of federal claims, most courts have found that the United States' priority attaches only to the net proceeds of an estate. In the context of a deceased debtor's estate, for example, courts have found that the United States has priority over the debts of the decedent, but not debts of the estate. *See, e.g.*, *United States v. MacIntyre*, No. H-10-2812, 2012 U.S. Dist. LEXIS 87597, at *13-18 (S.D. Tex. June 25, 2012).

Most courts have recognized that administrative expenses of an estate[20] have superpriority over claims of the United States.[21] Administrative expenses are the necessary and reasonable costs of

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[16] *United States v. Fisher*, 6 U.S. 358, 396-397 (1805) (rejecting an argument that granting priority to the United States would "interfere with the right of the state sovereignties respecting the dignity of debts"); *United States v. Cole*, 733 F.2d 651, 655 (9th Cir. 1984) (holding that a state statute could not supersede the federal government's priority under 31 U.S.C. § 3713)*; but see U.S. Dep't of Treasury v. Fabe*, 508 U.S. 491, 507-08 (1993) (holding that the anti-exemption provisions of the McCarran-Ferguson Act required state statutes enacted "for the purpose of regulating the business of insurance" to be given priority over conflicting federal laws).

[17] *United States v. Summerlin*, 310 U.S. 414, 418 (1940) (holding that a state statute requiring the United States to file its probate claim within eight months "cannot deprive the United States to enforce its claim"); *see also United States v. Vibradamp Corp.*, 257 F. Supp. 931, 940 (S.D. Cal. 1966); *Snyder*, 207 F. Supp. at 190-91.

[18] *Id.*

[19] Congress included the bankruptcy exception in the 1978 amendments to the Federal Priority Statute to create a "coherent bankruptcy policy, eliminate[] special priorities found in other laws and bring[] all priorities into the bankruptcy code itself." H.R. Rep. No. 95-595, at 252 (1977), as reprinted in 1978 U.S.C.C.A.N. 5963, 6242; *see also United States v. Estate of Estate of Romani*, 523 U.S. 517, 531, n.15 (1998); *Arrowsmith v. Mallory (In re Health Diagnostic Lab., Inc.)*, 588 B.R. 154, 164 (Bankr. E.D. Va. 2018).

[20] Expenses that may gain superpriority over claims of the United States have generally arisen in the context of a debtor that is an estate. However, 31 U.S.C. § 3713 applies to all debtors, not just estate debtors.

[21] *Abrams v. United States*, 274 F.2d 8, 12 (8th Cir. 1960) (interpreting a precursor to 31 U.S.C. § 3713 and finding that administrative expenses, such as reasonable legal fees, have priority over the claims of the United States); *Kennebec Box Co. v. O.S. Richards Corp.*, 5 F.2d 951, 952 (2d Cir. 1925) (interpreting a precursor to 31 U.S.C. § 3713 and holding that administrative expenses were entitled to priority over federal debts); *United States v. Idaho Falls Assocs.*, 81 F. Supp. 2d 1033, 1043 (D. Idaho 1999) ("Itt has long been settled that administration expenses of a receivership take precedence over claims asserted by the Government pursuant to 31 U.S.C. § 3713."); *Estate of Capato v. United States*, No. 92-648-JO, 1992 U.S. Dist. LEXIS 18217, at *5-7 (D. Or. Nov. 17, 1992) (defining "administrative expenses" by reference to Internal Revenue Service regulations and applicable state law). *But see Estate of Friedman v. Cadle Co.*, No. 3:08CV488, 2009 U.S. Dist. LEXIS 130505, at *4 n.8, 13-14 (D. Conn. Sept. 8, 2009) (finding that the Internal Revenue Service had priority over administrative expenses because it had a federal tax lien and, therefore, 31 U.S.C. § 3713 did not govern).

administering an estate, including accounting, appraisers' and attorneys' fees, court costs, and other costs associated with maintaining property of an estate.[22] Courts generally have also given priority to reasonable funeral and burial expenses,[23] provided that they are reasonable in amount.[24] However, because the statute does not explicitly provide for the prior payment of administrative and funeral expenses, agencies should consider whether to cede priority to such expenses.

Furthermore, the federal priority statute may not give priority to the United States over creditors with a perfected security interest in the debtor's property.[25] Another circumstance in which courts have recognized exceptions to the federal priority statute is when another specific federal statute governs the claim.[26]

III. PERSONAL LIABILITY OF REPRESENTATIVE

When a debtor has insufficient assets to pay all of its debts, the debtor's representative can be held personally liable to the United States if he or she pays the general creditors of an estate without first satisfying the Government's claims.[27] In this context, the representative includes any person who has control over the debtor's assets, not necessarily just a personal

[22] *See generally id.*
[23] Courts generally have distinguished between "funeral and burial expenses" and "administrative expenses," but have—without analysis— nevertheless accorded them both priority over claims of the United States. *See United States v. Marshall*, 771 F.3d 854, 877 (5th Cir. 2014); *MacIntyre*, 2012 U.S. Dist. LEXIS 87597, at *15-16; *United States v. Weisburn*, 48 F. Supp. 393, 397 (E.D. Pa. 1943). The theory for according funeral expenses priority appears to be that they were not obligations of the decedent when the decedent was alive.
[24] *Marshall*, 771 F.3d at 877 (holding an estate representative personally liable for funeral expenses above the maximum amount allowed under state law); *MacIntyre*, 2012 U.S. Dist. LEXIS 87597, at *15-16 (same).
[25] *United States v. Estate of Romani*, 523 U.S. 517, 534 (1998) ("[N]othing in the text or the long history of interpreting the federal priority statute justifies the conclusion that it authorizes the equivalent of a secret lien as a substitute for the expressly authorized tax lien that Congress [in the Tax Lien Act of 1966] has said 'shall not be valid' in a case of this kind."); *Cole*, 733 F.2d at 654-655 (indicating that United States did not dispute prior payments made to choate lienholders). *But see Straus ex rel. Tasemkin, Inc. v. United States*, 196 F.3d 862, 865-66 (7th Cir. 1999) (recognizing the priority of the United States despite state's choate tax lien).
[26] *See Estate of Romani*, 523 U.S. at 530-31 ("On several prior occasions the Court had . . . concluded that a specific policy embodied in a later federal statute should control our construction of the priority statute, even though it had not been expressly amended.").
[27] 31 U.S.C. § 3713(b); *see also United States v. Crocker*, 313 F.2d 946, 948-49 (9th Cir. 1963) (holding a receiver who distributed the debtor's assets personally liable to the United States under a precursor to 31 U.S.C. § 3713); *United States v. Marin*, No. 18 CV 9307 (VB), 2020 U.S. Dist. LEXIS 13158, at *14 (S.D.N.Y. Jan. 22, 2020) (the representative of the estate had fiduciary responsibilities to the creditors); *U.S. Dep't of Justice v. Sperry*, No. 1:12-cv-00320, 2013 U.S. Dist. LEXIS 58530, at *22-23 (S.D. Ind. Apr. 24, 2013) (finding an estate representative liable because he wrongfully distributed estate assets to himself and a commercial creditor prior to paying the federal claim); *United States v. Blakeman*, 750 F. Supp. 216 (N.D. Tex. 1990) (finding an executor who paid the state inheritance tax before paying the federal estate tax personally liable for the outstanding federal tax), *rev'd in part on other grounds*, 997 F.2d 1084 (5th Cir. 1992).

representative.[28] It is this personal liability provision that gives the federal priority statute "teeth."[29]

Courts generally hold the representative liable only if the representative: (1) pays a non-federal debt (2) before paying a claim of the United States (3) at a time when the [debtor] was insolvent, (4) if he had knowledge or notice of the claim.[30]

The party seeking relief from such personal liability bears the burden of showing that at least one of these elements was not satisfied.[31] While the statute does not explicitly require that the representative have "knowledge" as a prerequisite to imposing personal liability, courts have interpreted the statute to include such a requirement due to the highly penal nature of imposing personal liability.[32] Either actual or constructive knowledge will generally satisfy this knowledge requirement.[33] A representative will not, however, be immune from personal liability if the representative pays non-federal claims before federal claims due to a belief (whether or not in good faith) that the federal claims are not valid.[34]

Moreover, a representative will only be held personally liable if the debtor is insolvent. 31 U.S.C. § 3713. A representative who makes a distribution to non-priority creditors before paying the United States generally will not be held liable if the debtor was not insolvent at the time of distribution to non-priority creditors, but later became insolvent as the result of other events, such as a decline in the market value of an estate asset.[35]

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[28] *King v. United States*, 379 U.S. 329, 337 (1964); *United States v. Tyler*, 528 Fed. Appx. 193, 201 (3d Cir. 2013) ("Courts also interpret the term 'representative' broadly. '[O]ne need not be a personal representative to come within the coverage of' § 3713(b); the 'decisive' factor 'is the element of control over the assets.'" (quoting *King*, 379 U.S. at 337)). In certain proceedings, the representative is referred to as an executor/executrix or an administrator/administratrix.

[29] *United States v. Moore*, 423 U.S. 77, 81 (1975).

[30] *United States v. Renda*, 709 F.3d at 480-81, 484 ("representative's actual knowledge of a federal claim is sufficient, notwithstanding that representative's reliance on the erroneous advice of counsel as to how to address the claim"); *see also MacIntyre*, 2012 U.S. Dist. LEXIS 87597, at *9; *United States v. Russell*, No. 00-75597, 2003 U.S. Dist. LEXIS 24246, at *17 (E.D. Mich. Dec. 30, 2003).

[31] *McNicol*, 829 F.3d at 81.

[32] *See Vibradamp Corp.*, 257 F. Supp. at 935-36; *see also United States v. Boots*, 675 F. Supp. 550, 552 (E.D. Mo. 1987).

[33] *See Marshall*, 771 F.3d at 875; *United States v. Volta*, No. 87-3891, 1988 U.S. App. LEXIS 22247, at *4 (9th Cir. 1988); *MacIntyre*, 2012 U.S. Dist. LEXIS 87597, at *11; *Idaho Falls Assocs.*, 81 F. Supp. 2d at 1042.

[34] *Marshall*, 771 F.3d at 875; *Renda*, 709 F.3d at 485; *MacIntyre*, 2012 U.S. Dist. LEXIS 87597, at *11-12.

[35] *Schwartz v. Commissioner*, 560 F.2d 311, 319 (8th Cir. 1977) ("Given the severity of personal liability, we are reluctant to impose it unless the statutory requirements for liability are satisfied. Therefore, we hold that the [representatives] can only be held personally liable for those distributions made after insolvency had occurred."); *United States v. Lutz*, 295 F.2d 736, 742 (5th Cir. 1961). *But see United States v. Johnson*, No. 2:11-CV-00087, 2013 U.S. Dist. LEXIS 106671 (D. Utah July 29, 2013), at *45 (finding that the Government stated a claim under section 3717(b) against the individuals who distributed the estate's assets because they accepted the risk that the heirs might fail to pay the requisite estate taxes).

IV. TRANSFER LIABILITY OF DISTRIBUTEES

In cases where a debtor's representative improperly pays general creditors of an estate without first satisfying the Government's claims, the Government may be able to recover the amount of its claim from the persons to whom the assets have been distributed.[36]

[36] *See United States v. Purdome*, 240 F. Supp. 221, 223 (W.D. Mo. 1963) (finding a transferee of decedent's estate, who was also the estate's representative, liable to the Government in the amount of the transferred assets under the trust fund theory); *Snyder*, 207 F. Supp. at 191 ("The United States may impress a trust on the funds in the hands of the residuary legatee which were not properly a part of the decedent's estate.")); *United States v. Anderson*, 66 F. Supp. 870, 871-72 (D. Minn. 1946) (finding the existence of a constructive trust in the amount of the Government's claim that had been distributed to decedents' sole heir).

C. DECEASED DEBTORS

I. INTRODUCTION

Death generally does not extinguish debts.[37] Thus, as with other types of debts, agencies must pursue collection of debts owed by deceased debtors.[38] There are, however, a few notable exceptions to the general rule that death does not extinguish debts. For example, certain student loans are discharged when the borrower dies.[39] In certain circumstances, death may also extinguish debts meant to be punitive, such as certain criminal debts.[40] In light of these exceptions, agencies should ensure that no law precludes continued collection before collecting on a debt owed by a deceased debtor.

Because an agency's right to collect a debt typically does not terminate with a debtor's death, an agency's obligation to attempt to collect a debt continues after the debtor's death. *See* 31 U.S.C. § 3711(a); 31 CFR § 901.1(a). Of course, as with collecting against any debtor, agencies should act fairly and appropriately when collecting debts owed by decedents.

While some debt collection tools may no longer be available or appropriate once a debtor dies (e.g., administrative wage garnishment), agencies have several other means through which to pursue debts owed by decedents. Among other things, an agency can pursue its claims through offset or probate. An agency can also pursue co-debtors to collect the full amount of its claim. Any agency should terminate its debt collection efforts on a debt owed by a decedent only if it has grounds to do so under 31 CFR § 903.3 or other applicable law.

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[37] *See Estate of Kahr v. Commissioner*, 414 F.2d 621, 626 (2d Cir. 1969) (stating that "[d]eath may be an avenue of escape from many of the woes of life, but it is no escape from taxes" and finding that the taxpayer's "death does not relieve his estate of liability"); *United States v. Wolin*, 489 F. Supp. 3d 21, 27 (E.D.N.Y. 2020) (stating that, in general, under the federal common law, a claim survives the debtor's death if it is "remedial" rather than "punitive"); *Brenton Bank & Tr. Co. v. Beisner*, 268 N.W.2d 196, 199 (Iowa 1978) ("death of a contract obligor does not relieve his estate of liability"); Fed. Trade Comm'n, Statement of Policy Regarding Communications in Connection with the Collection of Decedents' Debts, 76 Fed. Reg. 44915 (Aug. 29, 2011) ("When a person dies, creditors and the debt collectors they hire usually have the right to collect on the person's debts from the assets of his or her estate.").

[38] *See* 31 U.S.C. § 3711(a)(1) (requiring agencies to collect all outstanding debts); 31 CFR § 901.1 (same); B-212728 (Comp. Gen. Aug. 27, 1984) ("The criteria for terminating collection of a claim of a deceased debtor are the same as those which apply to other debtors."); *see also* 31 U.S.C. § 3701(b)(1) (defining "debt").

[39] *See* 20 U.S.C. § 1087(a)(1).

[40] *E.g.*, 18 U.S.C. § 3613(b) ("The liability to pay the fine shall terminate . . . upon the death of the individual fined."); *United States v. Parsons*, 367 F.3d 409, 413 (5th Cir. 2004) (citing *United States v. Mmahat*, 106 F.3d 89, 93 (5th Cir. 1997)) (noting that whether a restitution order should abate along with a conviction after a defendant's death depends on whether the restitution was intended to punish the defendant or to compensate victims); *United States v. Christopher*, 273 F.3d 294, 298-99 (3d Cir. 2001); *United States v. Wright*, 160 F.3d 905, 908-09 (2d Cir. 1998); *United States v. Dudley*, 739 F.2d 175, 177-78 (4th Cir. 1984); *United States v. Oberlin*, 718 F.2d 894, 895 (9th Cir. 1983); *United States v. Wolin*, 489 F. Supp. 3d 21, 28 (E.D.N.Y. 2020) (discussing different tests to determine whether a debt was remedial or penal for the purpose of deciding whether the debt survived the debtor's death); *United States v. Estate of Schoenfeld*, 344 F. Supp. 3d 1354, 1370 (M.D. Fla. 2018) (applying the factors set forth in *Kennedy v. Mendoza-Martinez*, 372 U.S. 144, 168-69 (1963), to determine whether a debt was remedial or penal for the purpose of deciding whether the debt survived the debtor's death).

II. OFFSET OF PAYMENTS TO A DECEDENT

Like any other creditor, the United States has the right to offset mutual debts.[41] Any payments due to the decedent can be offset for debts owed by the decedent, including the decedent's final tax refund payment,[42] final federal salary payment, and certain survivor benefits being made to the decedent's spouse in the form of annuity payments.[43]

The decedent and the estate of the decedent are generally considered to be two separate legal entities.[44] Therefore, before conducting an offset, agencies should consider whether any payment they are making should be made to the decedent or to the decedent's estate, as well as whether the debt is owed by the decedent, the decedent's estate, or both.

III. ASSERTING CLAIMS THROUGH PROBATE PROCESS

A. BASICS OF PROBATE

The term "probate"[45] describes the process for identifying and gathering the property (the "estate") of a person who has died (the "decedent"), paying the decedent's debts, and distributing the decedent's remaining property to the decedent's heirs.[46] *See generally* UNIF. PROBATE CODE.[47] By probating the estate through an orderly legal process, title to the decedent's assets can be transferred from the decedent to the decedent's heirs. If the probate process is administered properly, the heirs will take title to the transferred assets free and clear of decedent's debts.

The probate process is governed by state law and local rules, which vary from jurisdiction to jurisdiction.[48] Generally, the probate proceeding takes place in the state where the decedent lived, but if the decedent owned real property in multiple states, there may be multiple probate proceedings. All of the assets an individual owns at the time of their death, other than non-

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[41] *See* Part III.D.
[42] Ordinarily, the representative of a decedent's estate files the decedent's final federal and state income tax returns. If there is an overpayment of taxes, the final tax refund payment to the estate may be subject to offset.
[43] *See* 31 U.S.C. § 3716; 31 CFR § 285.5 (requiring disbursing officials to offset payments to be made to a payee to satisfy the payee's debts, and defining "payee" as "a person who is entitled to the benefit of all or part of a payment from a disbursing official").
[44] *E.g.*, *Bankers' Tr. Co. v. Bowers*, 295 F. 89, 94 (2d Cir. 1923); *Catherwood v. United States*, 280 F. 241, 242 (E.D. Pa. 1922); *Prashker v. Comm'r*, 59 T.C. 172, 177 (1972).
[45] As used in this *Treatise*, the term "probate" refers to both formal probate proceedings and small estate administrations. For small estate administrations, creditors generally have the option to initiate a formal probate proceeding if necessary to protect their interests.
[46] For the purposes of this *Treatise*, the term "heirs" refers to the persons who are entitled to the decedent's assets (after payment of valid debts), whether identified by will or state intestate law.
[47] The Uniform Probate Code is a uniform act that was drafted by the National Conference of Commissioners on Uniform State Laws. It is cited in this *Treatise* as an example of typical state law because it has been adopted (in modified form) by several states. *See* LEGISLATIVE ENACTMENT STATUS—PROBATE CODE (2019), https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=c9e55522-8363-74ba-e087-175af9e4c93e.
[48] Because the applicable laws and procedures differ from jurisdiction to jurisdiction, this *Treatise* incorporates only a high-level overview of the probate process and does not attempt to address the many nuances of probate law.

probate assets,[49] become part of the decedent's estate. After all creditors are paid, the estate is distributed to the decedent's heirs in accordance with the decedent's will or, if there is no will, pursuant to state intestate law. State law also sets forth rules for notification and presentment of a claim against the estate within a specific time and delineates the order for payment of claims in the event of an insolvent estate.

The probate process starts with a petition for probate. The probate court determines the validity of the will (if one exists) and appoints an estate representative[50] to oversee the distribution of the assets of the estate. The estate representative generally owes a fiduciary duty to the creditors and heirs of the estate and is responsible for notifying known creditors and heirs of the probate proceeding. The estate representative is also responsible for the collection, inventory, and appraisal of all of the decedent's probate assets, identification of the estate's liabilities and payment of valid debts from the estate's assets. [51]

B. FILING CLAIMS

In most cases, state probate law requires the estate representative to send known creditors a notice that the decedent's estate is being probated, and the estate representative may be required to publish a death notice in a local paper to notify unknown creditors.[52]

Following notification, generally, creditors who are owed a debt must file a claim to participate in the distribution of the estate. This claim must be filed within the timeframe set by the court (or applicable law). Most jurisdictions have a form that creditors can use to file their claims. The creditor's claim should provide sufficiently detailed information about the debt, including the amount owed and the nature of the debt. The estate representative may contact the creditor for additional information if further proof of the claim is needed. The estate representative must then either accept or reject the claim and notify the creditor of the decision. A creditor whose claim is rejected can seek a judicial determination of the claim's validity.

C. PRIORITY OF FEDERAL CLAIMS AND SOVEREIGN IMMUNITY

Claims of the United States have priority over the claims of all other creditors. 31 U.S.C. § 3713; Part II.B. Also, under the doctrine of sovereign immunity, federal agencies generally are not required to comply with state probate procedures to recover their claims.[53] Rather than filing and prosecuting its claim through the probate process, for example, a federal agency may simply

[49] "Non-probate assets" are excluded from the probate process and can include the following: property owned jointly with a right of survivorship or as tenants in the entirety; certain trust property; and life insurance proceeds (if the designated beneficiary is still alive).
[50] *See supra* note 28 and accompanying text.
[51] *See, e.g.*, UNIF. PROBATE CODE § 3-801 (amended 2019).
[52] *See, e.g.*, *id*.
[53] *See Viles v. Comm'r*, 233 F.2d 376, 380 (6th Cir. 1956) (citing *Field v. United States*, 34 U.S. 182 (1835)); *Coppola*, 1994 U.S. Dist. LEXIS 16848, at *24 ("The United States need not participate in the probate proceedings concerning the estate in order to assert its priority under 31 U.S.C. § 3713."); *United States v. Boots*, 675 F. Supp. 550, 552 (E.D. Mo. 1987) (holding that "it is irrelevant that the Government did not file a formal claim in the probate proceeding" to collect its overpayment of veterans benefits).

notify the estate representative of its claim.[54] If an agency chooses this route, it is good practice for the agency to put this notification in writing and to explicitly assert the debt's priority under 31 U.S.C. § 3713.

State statutes of limitations also do not apply to the United States.[55] Therefore, a delay by the United States in enforcing its right to collect a debt, while not advisable, generally will not extinguish its right to collect the debt, even if the estate has been closed and assets already have been distributed.[56]

IV. CLAIMS AGAINST ESTATE REPRESENTATIVE

Regardless of whether a federal agency files a claim with the probate court or notifies the estate representative directly, an estate representative who pays non-federal debts owed by the decedent before paying debts owed to the United States generally will be personally liable to the extent of the unpaid federal claims.[57]

V. CO-DEBTORS, FAMILY MEMBERS, AND TRANSFEREES

Although federal agencies generally cannot collect outstanding debts from non-debtors, they can, and should, continue to collect against co-debtors. *See* 31 CFR § 902.4(a). Agencies may also accept voluntary payments from non-debtors. However, agencies should be careful not to

[54] *See Vibradamp Corp.*, 257 F. Supp. at 937 (stating that the United States can choose to ignore the probate proceedings and, instead, notify and look to the executor to preserve the priority of its claim); *United States v. Luce*, 78 F. Supp. 241, 243 (D. Minn. 1948) (notifying the estate representative of the Government's claim "is tantamount to the filing of a claim with the Probate Court").

[55] *United States v. Summerlin*, 310 U.S. 414, 416 (1940) (holding that a state statute requiring the United States to file its probate claim "within eight months cannot deprive the United States of its right to enforce its claim"); *see also Vibradamp Corp.*, 257 F. Supp. at 940; *United States v. Snyder*, 207 F. Supp. 189, 190-91 (E.D. Pa. 1962); *United States v. Deimer*, 140 F. Supp. 88, 89 (D. Wyo. 1953); *Luce*, 78 F. Supp. at 243; *United States v. Anderson*, 66 F. Supp. 870, 871 (D. Minn. 1946); *Reconstruction Fin. Corp. v. Faulkner*, 122 A.2d 263, 264 (N.H. 1956).

[56] As one court noted:

> [I]t seems clear that the Government's failure to file its claim during the time required by the state statutes and court order does not defeat its right to enforce its claim . . . against the administrator of the deceased. Like reasoning sustains the conclusion that the Government's failure to file the claim prior to the final decree of distribution and discharge of the administrator is unimportant to its rights against the heir.

Anderson, 66 F. Supp. at 871; *see also Snyder*, 207 F. Supp. at 191 ("[T]he unique rights of the United States were not affected by the decree of [distribution of estate assets] of the state court where the United States did not appear in or become a party to the proceedings."); *United States v. Weisburn*, 48 F. Supp. 393, 397 (E.D. Pa. 1943) ("[N]either a discharge of an executor of an insolvent estate, an approval of his account, nor the distribution of assets, relieve him from liability and debts due the United States.").

[57] 31 U.S.C. § 3713(b) ("A representative of a person or an estate . . . paying any part of a debt of the person or estate before paying a claim of the Government is liable to the extent of the payment for unpaid claims of the Government."); *see also* Part II.B; *but see Vibradamp Corp.*, 257 F. Supp. at 937 (interpreting a precursor to 31 U.S.C. § 3713 and holding that because the executors were unaware of the United States' intent to assert its claim against the decedent's estate, the United States could not hold the executors personally liable for distributing the estate's assets without regard to the priority of the United States' claim).

request payments from non-liable family members or create the impression that they might be liable for the decedent's debt.[58]

[58] The Fair Debt Collection Practices Act (FDCPA) does not apply to the United States, *see* 15 U.S.C. § 1692a(6), but it can serve as useful guidance to agencies. The FDCPA prohibits debt collectors from using harassing or deceptive tactics to collect debts. *See, e.g.*, 15 U.S.C. § 1692; *Sparks v. Phillips & Cohen Assocs*., 641 F. Supp. 2d 1234, 1245-47 (S.D. Ala. 2008) (stating that the FDCPA does not preclude debt collectors from contacting a decedent's daughter to encourage voluntary payment of the decedent's debts in a non-harassing, non-deceptive manner); Fed. Trade Comm'n, Statement of Policy Regarding Communications in Connection with the Collection of Decedents' Debts, 76 Fed. Reg. at 44922-23 (stating that although family members generally are not liable for paying the decedent's debts, debt collectors may contact family members to discuss the decedent's debts).

D. DEBTORS IN BANKRUPTCY

I. BANKRUPTCY OVERVIEW

A. INTRODUCTION

The commencement of a bankruptcy proceeding under title 11 of the United States Code (the Bankruptcy Code) can have a substantial effect on a creditor's ability to collect against a debtor. Nevertheless, an agency owed a debt by a debtor that has filed for bankruptcy protection still has an obligation to affirmatively pursue collection of the debt, subject to the restrictions imposed by the Bankruptcy Code, unless it has authority to suspend or terminate debt collection action. 31 U.S.C. § 3711(a); 31 CFR § 901.1.

This section describes some basic bankruptcy concepts and addresses some of the factors that agencies should consider when a debtor files for bankruptcy protection, including the automatic stay that goes into effect immediately upon filing and which a creditor must observe or risk sanctions. Bankruptcy is a complex area of the law. This section of the *Treatise* is provided to alert agencies to common bankruptcy issues and should not be relied on as a thorough explanation of bankruptcy law. Agencies should consult with their own counsel and/or the Department of Justice (DOJ) as appropriate before taking action on debts affected by bankruptcy.

B. THE BANKRUPTCY PROCESS

Bankruptcy is the process through which a debtor can obtain relief from some or all of its[59] indebtedness. This relief can come in the form of a court-approved repayment plan and/or a full or partial discharge (or forgiveness) of indebtedness. In exchange for this relief, the debtor may be required to surrender some or all of its assets and/or comply with the terms of the court-approved repayment plan. The proceeds generated from the sale of the debtor's assets or the payments made pursuant to the repayment plan will be distributed to the debtor's creditors in accordance with the Bankruptcy Code.

A bankruptcy proceeding begins upon the filing of the bankruptcy petition, usually by the debtor (considered a "voluntary" proceeding) or, on rare occasions, by the debtor's creditors (considered an "involuntary" proceeding). 11 U.S.C. §§ 301, 303. Along with the bankruptcy petition, the debtor must file schedules, which provide information about the debtor's financial status, including the debtor's assets and liabilities. *Id.* § 521. Immediately upon the filing, an automatic stay takes effect and generally lasts the entire duration of the bankruptcy case. *Id.* § 362(a), (c). The stay operates much like an injunction, protecting the debtor and the debtor's estate from creditors and nearly all types of collection action. *Id.* § 362(a). The purpose of the stay is to prevent a race to the courthouse by a single creditor and, instead, allow an equitable distribution of assets. The automatic stay also halts collection action to allow the debtor to come

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[59] A debtor can be a natural person or an entity. For simplicity, this chapter generally uses the pronoun "it" to when referring to a debtor. Also, the terms "debtor," "debtor in possession," and "trustee" each have different meanings, and cannot always be used interchangeably. Nevertheless, because this *Treatise* provides only a high-level overview of bankruptcy law, this chapter generally uses the term "debtor" to refer to the debtor in bankruptcy, the debtor in possession, and/or the trustee managing the debtor's estate.

up with a repayment plan. The filing of the bankruptcy petition also triggers the creation of the bankruptcy estate. *Id.* § 541(a). Except for certain enumerated exemptions, the estate consists of all of the debtor's interests in property at the time of filing, both legal and equitable, including real property and personal property (e.g., cars, cash, government-issued licenses and permits, business goodwill, etc.). *See id*.

C. TYPES OF BANKRUPTCY

The Bankruptcy Code, which governs the rights of debtors, creditors and other interested parties in bankruptcy proceedings, is divided into several chapters. Chapters 1, 3, and 5 are general provisions of the Bankruptcy Code that govern all bankruptcy proceedings, while the remaining chapters govern specific types of bankruptcy proceedings. Bankruptcy cases typically fall into one of two categories: liquidation (where creditors are paid the proceeds that result from a sale of a debtor's nonexempt property) or reorganization (where the debtor restructures its liabilities and forms a plan to repay creditors, in whole or in part, over time).[60]

(1) Liquidation (Chapter 7)

Chapter 7, available to individuals, partnerships, and corporations, provides for liquidation of a debtor's nonexempt assets as of the petition date as the means of satisfying creditors' claims. 11 U.S.C. § 109(b). The debtor's future income is not considered as a means of satisfying creditors' claims. *See id.* § 726. A trustee is appointed from a panel administered by the United States Trustee[61] to control and liquidate the debtor's nonexempt property and to distribute the proceeds of any liquidation to the creditors. *Id.* §§ 701-704. Regardless of whether a debtor's nonexempt property generates sufficient proceeds to satisfy all claims, individual debtors will receive a discharge at the conclusion of a chapter 7 case. *Id.* § 727. Non-individual debtors do not receive a discharge but will cease to exist. *See id.* §§ 726-27.

(2) Reorganization (Chapters 11, 12 and 13)

a) Chapter 11

Chapter 11 can be used by individual debtors but is far more commonly used by business debtors. *See id.* § 109(d) (describing what types of persons can be chapter 11 debtors). Chapter 11 allows a debtor to restructure its indebtedness. A chapter 11 filing provides the debtor with significant flexibility to repay some or all of its debts, allowing for repayment out of future income or through the sale of assets. During a chapter 11 case, the debtor generally stays in control of its estate, assuming a fiduciary role as a "debtor in possession." *Id.* §§ 1101, 1107.

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[60] Chapters 9 and 15 of the Bankruptcy Code are not discussed in this *Treatise*. A chapter 9 bankruptcy, which allows financially-distressed municipalities to negotiate with creditors to adjust its debts, is the exclusive remedy available to municipalities under the Bankruptcy Code. *Id.* § 109(c). A chapter 15 bankruptcy, also known as an ancillary or cross-border proceeding, facilitates coordination among courts and estate representatives in different countries to enhance efficiency and avoid inconsistent outcomes. *Id.* §§ 1525-1532.

[61] In Alabama and North Carolina, the duties of the United States Trustee are performed by Bankruptcy Administrators.

In chapter 11 cases, the debtor typically negotiates with its significant creditors and stakeholders regarding the reorganization of its debts through a plan of reorganization. *See id.* § 1126. If a negotiated resolution fails, however, a plan of reorganization may still be confirmed by the court if it meets the statutory requirements. *Id.* § 1129. Generally, for business debtors, confirmation of a plan discharges all pre-confirmation debts not paid in the plan. *Id.* § 1141(d)(1). For individuals, debts are generally discharged after all payments required by the plan have been made. *Id.* § 1141(d)(5).

b) Chapter 12

Chapter 12 cases are available exclusively to family farmers and family fishermen, which may include individuals, corporations, and partnerships. *Id.* §§ 109(f), 101(18)-(19). A trustee is appointed in each chapter 12 case, but the trustee generally does not control the debtor's farm or fishing operation. *See id*. §§ 1202-03. Chapter 12 allows the farmer or fisherman to restructure its debts, while retaining both ownership and use of its business. *Id.* § 1203. To be eligible for a chapter 12 filing, the farmer or fisherman must have debt within limits prescribed by the Bankruptcy Code (which are periodically revisited), as well as regular annual income out of which payments towards the reorganization plan may be made. *Id.* § 109(f). Once a debtor completes the payments required under the plan and satisfies certain other requirements, the debtor receives a discharge. *Id.* § 1228.

c) Chapter 13

Chapter 13 can be used by individual debtors that have regular income to contribute to a plan to adjust their debts and have debts within the limits prescribed by the Bankruptcy Code (which are periodically revisited). *Id.* § 109(e). A standing chapter 13 trustee (and, sometimes, more than one) is appointed in each judicial district to serve as the representative of the chapter 13 estates, but the chapter 13 trustee does not seize control of the debtor's assets. *Id.* §§ 1302-1303. Instead, the debtor makes payments into its plan, which is administered by the trustee who then makes distribution payments to creditors. Once a debtor completes the payments required under the plan and satisfies certain other requirements, the debtor receives a discharge. *Id*. § 1328.

II. SOVEREIGN IMMUNITY

The United States is immune from suit unless it consents to be sued. *E.g.*, *Fed. Deposit Ins. Corp. v. Meyer*, 510 U.S. 471, 475 (1994); *United States v. Sherwood*, 312 U.S. 584, 586-87 (1941). The terms of the Government's consent to suit define a court's jurisdiction over a case. *Id*. The Bankruptcy Code provides a limited waiver of sovereign immunity. *See* 11 U.S.C. § 106. Section 106 of the Bankruptcy Code is a forum waiver, which means that the waiver applies to the forum for raising claims and does not waive sovereign immunity for causes of action for which the United States would have been immune in a non-bankruptcy context. *Id.* § 106(a)(5) ("Nothing in this section shall create any substantive claim for relief or cause of action not otherwise existing under this title, the Federal Rules of Bankruptcy Procedure, or nonbankruptcy law.").

By filing a proof of claim,[62] for example, the Government "is deemed to have waived sovereign immunity with respect to a claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose." *Id*. § 106(b). In other words, debtors may assert compulsory counterclaims up to or exceeding the value of the Government's claim. *See id.* In addition, waiver of sovereign immunity by one federal agency could theoretically subject other federal agencies to the jurisdiction of the bankruptcy court. Agencies involved in bankruptcy proceedings, therefore, should coordinate with each other when appropriate.

Section 106(c) of the Bankruptcy Code also permits a debtor to setoff (or "offset") the agency's claim against the debtor by the debtor's claim against the agency. *Id.* § 106(c). In other words, section 106(c) of the Bankruptcy Code allows the debtor to assert permissive counterclaims up to the value of the agency's claim. *See id.*

III. PROOF OF CLAIM

A. CLAIM

For purposes of the Bankruptcy Code, a claim is a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." *Id*. § 101(5)(A). A claim also includes the "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured." *Id.* § 101(5)(B). That is, a "claim" for purposes of the Bankruptcy Code is broader than a "claim" under 31 U.S.C. § 3701(b), because a claim under the Bankruptcy Code could include amounts that an appropriate Government official has not yet determined to be due. *Compare id.* § 101(5)*, with* 31 U.S.C. § 3701(b).

B. CONTENTS OF A PROOF OF CLAIM

A proof of claim[63] is "a written statement setting forth a creditor's claim" against the debtor. FED. R. BANKR. P. 3001(a); *see also* 11 U.S.C. §§ 501-02. Determining whether to file a proof of claim depends on a variety of factors. For example, the agency must weigh the minimal expense of filing a proof of claim and monitoring the bankruptcy case with the likelihood of collection. *See* 31 CFR § 903.3 (outlining the circumstances in which agencies can terminate debt collection activity). Filing a proof of claim for a $5,000 debt may be worthwhile if the debtor has substantial assets. *See id.* Claims are not filed in no-asset cases.[64] In addition and as discussed above, by filing a proof of claim, agencies may be waiving sovereign immunity and

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[62] For more information on proof of claims, see section III (Proof of Claim), below.

[63] *See* PROOF OF CLAIM FORM (FORM B-10) [hereinafter FORM B-10], *available at* https://www.uscourts.gov/forms/bankruptcy-forms/proof-claim-0.

[64] When a creditor received notice of the bankruptcy filing, the notice will indicate whether the bankruptcy is considered an asset or no-asset case.

subjecting themselves—and, potentially, other federal agencies—to the jurisdiction of the bankruptcy court. 11 U.S.C. § 106(b).

A proof of claim and must "conform substantially" to Form B-10. Fed. R. Bankr. P. 3001(a), 9009. The proof of claim should include the agency's name, the debtor's name, the case number, the amount of the claim, the basis for the claim, and whether all or part of the claim has priority or is secured. *See* FORM B-10. Agencies should state the entire amount of the debt as of the petition date, including accrued interest, penalties, and costs. 11 U.S.C. § 502. An agency may file a proof of claim, even if the exact amount of the claim is not known. *Id.* §§ 101(5), 502(c). The deadline for agencies to file their proofs of claim is generally 180 days after the petition date. FED. R. BANKR. P. 3002(c)(1). Copies of any evidentiary documents relevant to the agency's claim should be filed with the proof of claim. *Id*. 3001(c)-(d). For example, if the claim is for a mortgage debt, information about the mortgage must be filed. Agencies should exercise caution before disclosing this supporting documentation, however, if there is an indication that disclosure would harm the United States or the interests of another party. In addition, a proof of claim should never be signed by anyone who does not have personal knowledge of the facts associated with the claim.

To avoid the inadvertent waiver of any rights when filing a proof of claim, agencies should include language, such as:

> This claim reflects the known liability of the debtor to this agency of the United States. The United States reserves the right to amend this claim to assert subsequently discovered liabilities. This agency holds subject to setoff against this claim a debt owed to the debtor of _____________ (amount). The identification of any sums held subject to setoff is without prejudice to any other right under 11 U.S.C. § 553 to set off against this claim debts owed by this or any other federal agency.

See U.S. ATTORNEYS' MANUAL, CIVIL RESOURCE MANUAL, Pt. 62 (discussing claims in bankruptcy) [hereinafter USAM CRM-62], *available at* https://www.justice.gov/usam/civil-resource-manual-62-claims-bankruptcy. This language can help ensure that the Government does not forego its right of setoff. Failure to include this language, however, will not necessarily constitute a waiver of the right of setoff.

C. PROOF OF CLAIM GENERALLY REQUIRED TO RECEIVE DISTRIBUTION

Federal agencies generally must file a proof of claim to participate in a distribution of the debtor's estate, even if the debtor has properly listed the agency's claim in its schedules. *E.g.*, 11 U.S.C. §§ 501, 502, 726(a). Filing a proof of claim is not required in a no-asset chapter 7 case in which there will be no distribution to the creditors. Likewise, it is not necessary to file a proof of claim in a chapter 11 case if the debtor has correctly listed the agency's claim in its schedules and no interested party has objected to the scheduled amount. *See id.* § 1111(a).[65] However, it is generally advisable to file claims in asset cases. Agencies

[65] However, failure to file a proof of claim in a chapter 11 case may preclude the creditor from voting on a proposed plan of reorganization. *See In re Woodward*, No. 11-40936, 2013 Bankr. LEXIS 4553, at *5 (Bankr. D. Neb. Oct.

owed secured debts also do not need to file a claim to participate in a distribution but, to the extent their debt is undersecured, or may be undersecured, filing a proof of claim is necessary for the full amount of their claim to be recognized. 11 U.S.C. § 506(d)(2). Even when filing a proof of claim is not strictly necessary to receive a distribution, filing a proof of claim can better protect an agency's interests.

D. GOVERNMENT PROCEDURES FOR FILING A PROOF OF CLAIM

Agencies should file their own proofs of claim. The proof of claim should be signed by someone with personal knowledge of the debt and the amount due. There are some circumstances, however, when the proof of claim may be filed by the DOJ, rather than the agency. For example, where the debt has already been referred to DOJ for collection purposes, the agency should coordinate with DOJ prior to filing a proof of claim. Similarly, an agency should consult with DOJ prior to filing a proof of claim if the agency believes that coordination with other agencies is needed to protect the interests of the United States or if the debt appears to arise from or involve fraud, a false claim, or misrepresentation. In addition, claims referred to DOJ should be accompanied by a Claims Collection Litigation Report. 31 CFR § 904.2; *see also* USAM CRM-62.

IV. AUTOMATIC STAY

A. INTRODUCTION

With few exceptions, the automatic stay, which bars nearly all actions against a debtor, takes effect immediately upon the commencement of the bankruptcy case. 11 U.S.C. § 362(a).[66] The automatic stay provides the debtor with the breathing room necessary to organize its affairs in a manner that maintains the status quo in the relationship among the debtor, creditors, and other parties-in-interest.

Collection actions taken in violation of the stay are void or voidable, even if the violation was unintentional, and an agency that takes such actions may be subject to sanctions if the violation was willful.[67] As such, agencies should carefully consider what actions to collect their debt are appropriate during the pendency of the stay, as any collection activity that takes place after they stay is instituted could be considered a violation of the stay. *See id*. § 362(a). The automatic stay applies to the collection of both dischargeable and non-dischargeable debts. *See id*. Administrative collection procedures, like offsets, demand letters, and administrative wage garnishment, must cease upon a debtor's filing for bankruptcy. *See id.* Agencies may be liable for actual damages, including costs and attorneys' fees, for willful violations of the automatic stay.[68]

31, 2013). Generally, federal agencies do not vote on plans with the exception of the Secretary of the Treasury or through DOJ. *See* 11 U.S.C. § 1126(a).

[66] The Bankruptcy Code provides for an exception to the automatic application of the stay when a debtor is a serial filer, such as when a debtor files a second repeat filing within a one-year period. *See id.* § 362(c)(3).

[67] *See id.* §§ 362, 549, 550.

[68] *Id.* § 362(k); *see also id.* § 105. The Bankruptcy Code does not provide for a waiver of sovereign immunity for punitive damages. *See id.* § 106. While the Bankruptcy Code allows actual damages only for "willful" violations of

B. AUTOMATIC STAY APPLIES REGARDLESS OF CREDITOR NOTICE

A debtor has a duty to file schedules with the court that list the debtor's assets and liabilities. *Id.* § 521(a)(1). The Bankruptcy Code requires that all creditors and certain other parties receive notice of the bankruptcy proceedings. *Id.* § 342; FED. R. BANKR. P. 2002. Additionally, debtors who are or may be liable to the agency must notify both the agency and DOJ upon the filing of a bankruptcy petition. FED. R. BANKR. P. 2002(j). Nevertheless, the stay applies regardless of whether the agency has actual or constructive notice of the bankruptcy.

C. THE AUTOMATIC STAY AS IT APPLIES TO SPECIFIC COLLECTION ACTIONS

(1) Demand Letters and Collection Calls

While the automatic stay does not bar non-coercive, non-harassing communication between the debtor and creditor, it generally does bar creditors from requesting payment from the debtor. *See* 11 U.S.C. § 362(a)(6). Before contacting a debtor, agencies should consider whether the communication might violate (or might be perceived as violating) the automatic stay. Moreover, if a debtor is represented by counsel, an agency should determine whether future communications should be directed to the debtor's counsel, rather than the debtor.

(2) Garnishment Orders

Unless a creditor has obtained relief from the stay, it should not issue any garnishment orders after the petition date, as doing so could constitute a violation of the automatic stay. *See id.* § 362(a)(6). Moreover, because the Bankruptcy Code generally prohibits "any act to create, perfect, or enforce any lien against property of the estate," an agency should suspend its efforts to collect under a garnishment order, even if it had perfected its interest prior to the petition date. *Id.* § 362(a)(4). The agency, however, should consider whether it may be entitled to relief from the stay. *See id.* § 362(d).

(3) Furnishing Information to Credit Bureaus

Agencies are generally required to submit information about delinquent nontax debts to credit bureaus. *Id.* § 3711(e)(1); OMB CIRC. A-129 at § IV.B.4. Agencies are also encouraged and, in some cases, required to submit information about current debts to credit bureaus as well. 31 U.S.C. § 3711(e)(5); OMB CIRC. A-129 at § IV.B.4. Once a debtor files for bankruptcy, however, an agency must determine whether continued reporting is appropriate. By reporting only accurate information, handling similarly situated debtors consistently, and not using the report as a method of coercing payment, agencies are unlikely to run afoul of the automatic stay when reporting debts to credit bureaus.[69]

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the automatic stay, all violations are problematic, and some courts apply a very low bar in determining what constitutes a "willful" violation.

[69] *See, e.g.*, *In re Porcoro*, 565 B.R. 314, 327 (Bankr. D.N.J. 2017) ("[T]he Court holds that the mere act of reporting a debtor's truthful credit information post-petition—but pre-discharge—without further evidence that the creditor is attempting to collect the debt, is not a violation of the automatic stay."); *In re Drake*, 2015 Bankr. LEXIS

(4) Accrual of Interest, Penalties, and Administrative Costs

Postpetition interest, penalties, and costs generally cannot be charged against the bankruptcy estate.[70] While the assessment of postpetition interest, penalties, and administrative costs, may violate the stay, the mere accrual of these charges generally is permissible.[71] To the extent the accrual of such charges is a mere bookkeeping entry, rather than an action against the debtor, accrual of these charges will not violate the bankruptcy stay.[72] Therefore, for accounting purposes, agencies should generally continue to accrue applicable charges. Doing so will protect the agency if the debtor's bankruptcy case is dismissed or if the debt is not discharged. It also allows the agency to pursue co-debtors who did not file for bankruptcy protection for the entire amount of the debt, including interest, penalties, and administrative costs. See, infra, section D(1).

(5) Setoff

While setoff rights are preserved in bankruptcy, creditors generally cannot exercise those setoff rights without first obtaining relief from the stay (or waiting until the conclusion of the bankruptcy case).[73] Accordingly, creditors generally may "freeze" or temporarily withhold funds without violating the automatic stay, provided that the creditor then timely seeks relief

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326, at *11 (Bankr. M.D.N.C. Jan. 6, 2015) (finding that a creditor's "failure to correct a false report for over a month after it received notice of its stay violation evidences a pattern of sluggishness and disorganization, and further supports this Court's finding of a willful violation [of an automatic stay]."); *Mortimer v. Bank of Am.*, No. C-12-01959, 2013 U.S. Dist. LEXIS 51877, at *25-26 (N.D. Cal. Apr. 10, 2013) (stating that "[t]he automatic stay does not render an otherwise accurate report of a delinquency inaccurate for the purposes of the FCRA"); *In re Burkey*, No. 09-12371, 2012 Bankr. LEXIS 5516, at *13-14 (Bankr. N.D.N.Y. Nov. 28, 2012) (declining to find a violation of the stay because there was no evidence that the credit union reported the loan as delinquent in an attempt to persuade the debtor or the codebtor to pay the loan in accordance with the terms of the note); *Mortimer v. JP Morgan Chase Bank, N.A.*, No. C 12-1936, 2012 U.S. Dist. LEXIS 108576, at *9 (N.D. Cal. Aug. 2, 2012) ("While it might be good policy in light of the goals of bankruptcy protection to bar reporting of late payments while a bankruptcy petition is pending, neither the bankruptcy code nor the [Fair Credit Reporting Act] does so"); *Mahoney v Wash. Mut., Inc. (In re Mahoney)*, 368 B.R. 579, 584-86 (Bankr. W.D. Tex. 2007) ("it is too great a leap to say, as a matter of law, that the mere reporting of a debt to a credit reporting agency is a *per se* violation of the" codebtor stay); *In re Weinhoeft*, 2000 Bankr. LEXIS 2246, at *4 (Bankr. C.D. Ill. Aug. 1, 2000) (finding that reporting a pre-petition debt to credit bureaus with intent to harass or coerce the debtor into paying the debt could constitute a violation of the stay); *Singley v. Am. Gen. Fin. (In re Singley)*, 233 B.R. 170, 173 (Bankr. S.D. Ga. 1999) (declining to dismiss the case because there was a genuine dispute regarding whether the creditor's reporting of accurate bankruptcy information was done with the intent to collect); *In re Sommersdorf*, 139 B.R. 700, 701-02 (Bankr. S.D. Ohio 1992) (finding a violation of the stay when creditor caused a credit report notation to be made on a non-debtor comaker's credit report because it was done in an effort to collect the account).

[70] *See generally* 11 U.S.C. § 726. However, the bankruptcy estate can be charged postpetition interest (and possibly costs and penalties) when the estate is solvent and on debts which are oversecured. *See id*. §§ 506(b), 726(a)(5).

[71] *See id.* § 362(a). *Compare id.* § 101(5) (defining "claim"), *with id.* § 101(12) (defining "debt"). *See also Bruning v. United States*, 376 U.S. 358, 360 (1964); *Salazar v. Comm'r*, 338 Fed. Appx. 75, 78 (2d Cir. 2009); *United States v. Monahan (In re Monahan)*, 497 B.R. 642, 649 (B.A.P. 1st Cir. 2013); *Jung Bea Han v. GE Capital Small Bus. Fin. Corp. (In re Jung Bea Han)*, 333 B.R. 881, 890 (Bankr. N.D. Fla. 2005); *In re Moore*, 307 B.R. 394, 396 n.3 (Bankr. S.D.N.Y. 2004); *Kerney v. Capital One Fin. Corp. (In re Sims)*, 278 B.R. 457, 470-72 (Bankr. E.D. Tenn. 2002).

[72] *See, e.g.*, *Jung Bea Han*, 333 B.R. at 890.

[73] 11 U.S.C. §§ 362(a)(7), 362(c)-(d), 553; *Citizens Bank v. Strumpf*, 516 U.S. 16, 18-19 (1995).

from the stay. *See Strumpf*, 516 U.S. at 18-19. In these circumstances, an agency should request the United States Attorney in the District where the case was filed to seek relief from the stay.

While the automatic stay may delay a creditor's right of setoff, it generally will not delay the creditor's right of recoupment. Unlike setoff, recoupment is only available where the mutual debts arise out of the same transaction or occurrence. This distinction between setoff and recoupment is important for the purposes of determining whether the proposed action will violate the automatic stay. In general, "a debtor may not assume the favorable aspects of a contract (postpetition payments) and reject the unfavorable aspects of the same contract (the obligation to repay prepetition overpayments by means of recoupment)." *Kosadnar v. Metro. Life Ins. Co. (In re Kosadnar)*, 157 F.3d 1011, 1016 (5th Cir. 1998) (quoting *Aetna Life Ins. Co. v. Bram (In re Bram)*, 179 B.R. 824 (Bankr. E.D. Tex. 1995)); *see also In re B & L Oil Co.*, 782 F.2d 155, 158-59 (10th Cir. 1986).

D. EFFECT OF STAY ON PARTIES WHO HAVE NOT FILED FOR BANKRUPTCY PROTECTION

(1) Effect of Stay on Co-Debtors

In chapter 12 and 13 cases, but not in chapter or 7 or 11 cases, the automatic stay prohibits collection actions against certain individuals who are liable with the debtor in bankruptcy on a debt but have not filed for bankruptcy protection themselves. Specifically, the co-debtor stay protects individuals who are liable on a consumer debt[74] with the debtor in bankruptcy, when that debtor has filed for bankruptcy protection under chapter 12 or 13. *See* 11 U.S.C. §§ 1201, 1301. If a creditor wants to collect against such an individual, the creditor must request relief from the co-debtor stay prior to initiating collection action.

The co-debtor stay, however, offers only temporary relief. The co-debtor's liability for the debt cannot be discharged, unless the co-debtor also files for bankruptcy. Once the bankruptcy case is closed, dismissed, or converted to a chapter 7, the co-debtor stay is lifted, and the creditor may pursue collection against the co-debtor even if the debtor that filed for bankruptcy protection received a general discharge.

(2) Effect of Stay on Spouses

Because spouses are not automatically liable for each other's debts, there may be circumstances where one spouse may choose to file for bankruptcy while the other spouse does not. To the extent the spouses are liable together on certain debts, the spouse that did not file for bankruptcy may be entitled to the protection of the co-debtor stay discussed above.

In addition, agencies should exercise caution prior to collecting from a debtor if the debtor's spouse has filed for bankruptcy. In community property states, for example, some courts

[74] The term "consumer debt" is defined as a "debt incurred by an individual primarily for a personal, family, or household purpose." 11 U.S.C. § 101(8).

have found that some or all of the property of the spouse who did not file for bankruptcy is included in the bankruptcy estate, and collection against property of the estate would violate the automatic stay even if the collection related to a debt owed only by the spouse who did not file for bankruptcy.[75]

E. THE AUTOMATIC STAY: EXCEPTIONS, RELIEF, AND TERMINATION

(1) Action Excepted from the Stay

The Bankruptcy Code excepts certain actions from the limits imposed by the automatic stay. 11 U.S.C. § 362(b). Exceptions from the stay include, among other things, audits and demands for tax returns and collection of domestic support obligations from property that is not part of the estate. *Id.* Government agencies generally are permitted to pursue administrative or judicial action against debtors pursuant to statutes or agency regulations, so long as there is a public policy purpose for doing so that is separate from recovering the debt owed. *Id.* § 362(b)(4). Prior to commencing or continuing such an action, the agency should consult its own counsel and/or DOJ. The automatic stay does not apply to criminal proceedings. *Id.* § 362(b)(1).

(2) Relief from the Stay to Take Action Against the Debtor

A creditor may seek relief from the stay to affect a setoff, exercise its rights to collateral, or take certain other actions. *Id.* §§ 105, 362(d). To obtain relief from the stay, the creditor must show cause for relief, as well as a colorable claim against property of the estate. *Id.* § 362(d). Courts are also empowered to grant retroactive relief from the stay. *See id*. § 362(d). Generally, creditors will obtain relief from the stay only when they have a secured claim or when they have setoff rights under 11 U.S.C. § 553.

(3) Termination of the Stay

The stay will usually terminate when the case is closed, dismissed, or when a discharge is granted or denied. *Id.* § 362(c)(2). The court may also modify or terminate the stay upon the request of a party in interest upon a showing of cause. *Id.* § 362(d)-(g).

V. DISCRIMINATION

Generally, creditors are barred from refusing service to the debtor when the refusal serves as a means of inducing the debtor to pay their debts. *Id.* § 525. Federal agencies should consult legal counsel prior to denying a person any right, benefit, or payment as a result of a bankruptcy filing.

[75] *See, e.g.*, *In re Thongta*, 401 B.R. 363, 367-68 (Bankr. E.D. Wis. 2009); *In re Passmore*, 156 B.R. 595, 599 (Bankr. E.D. Wis. 1993).

VI. AVOIDANCE ACTIONS

A. INTRODUCTION

Any entity in possession of property of the estate generally must to turn over that property to the trustee. *Id.* § 542(a). Debtors, for example, generally must turn over nonexempt property to the trustee. *See id.* The trustee has the power to recover property of the estate not in its possession, including the power to avoid, or set aside, certain transactions or transfers of property. *See, e.g.*, *id*. §§ 544-549. A trustee can avoid certain actions taken during the bankruptcy proceeding and can also avoid certain actions taken prior to the bankruptcy filing. For example, the trustee can generally avoid actions taken in violation of the automatic stay,[76] preferential transfers that occurred prior to the initiation of the bankruptcy proceeding,[77] fraudulent transfers,[78] or certain other transactions.[79]

B. AVOIDING GARNISHMENTS

The trustee may attempt to recover amounts garnished from wages, bank accounts, or other property. Whether the trustee can "avoid" the garnishment depends on a variety of factors, including when the garnishment order was issued, when the garnishments were taken in relation to the petition date, and the underlying non-bankruptcy law permitting the garnishment. Therefore, agencies should consult with their counsel and/or DOJ before returning amounts collected pursuant to a garnishment order.

(1) Postpetition Garnishments

If a creditor garnished any amounts in violation of the automatic stay, the trustee generally can avoid those collections. *Id.* §§ 362, 549. In fact, once notified of the bankruptcy, creditors have an affirmative duty to return the garnished funds. *See, e.g.*, *Sternberg v. Johnston*, 595 F.3d 937, 945 (9th Cir. 2009); *Johnson v. Smith (In re Johnson)*, 501 F.3d 1163, 1172 (10th Cir. 2007); *Sucre v. MIC Leasing Corp. (In re Sucre)*, 226 B.R. 340, 348 (Bankr. S.D.N.Y. 1998).

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[76] *Id.* § 549.

[77] During the 90-day period preceding the bankruptcy filing (or, in the case of insiders, one year), transactions that put the creditor in a better position vis-à-vis other creditors may be avoidable. *See id.* § 547. Specifically, a trustee may avoid any transfer of the debtor's property that enables a creditor to receive more than it would have in a chapter 7 liquidation, if the transfer was made:

- to or for the benefit of a creditor for or on account of an antecedent debt;
- while the debtor was insolvent; and
- within 90 days prior to the petition date (or, if the transferee creditor is an insider, within one year prior to the filing).

Id.

[78] The fraudulent transfer power protects creditors from transactions designed to unfairly drain, or which have the effect of unfairly draining, the pool of assets available to satisfy creditors' claims. *See id.* § 548. If a transfer is made with actual or constructive fraud, the debtor or trustee will generally be able to avoid such transfers. *See id.*

[79] *See, e.g.*, *id*. §§ 522(f) (allowing avoidance of certain liens that impair exempt property), 544(b) (permitting avoidance of certain transfers by unsecured creditors), 553 (allowing recovery of amounts offset by a creditor during the 90 days prior to the petition date).

(2) Prepetition Garnishments

A trustee can also generally recover any amount garnished pursuant to a garnishment order issued during the 90 days preceding a debtor's bankruptcy filing. *See* 11 U.S.C. § 547. Whether a trustee must return garnishments paid during the preference period will depend on the specific facts and the non-bankruptcy law under which the garnishment order was issued.

One of the determining factors will be when the "transfer" occurred. *See id.* § 547(e)(2). If a creditor perfected a lien prior to the preference period and the debtor had already obtained an interest in the property, garnishments taken pursuant to that lien are not preferential transfers because, at the time the funds were garnished, the debtor no longer had a right to those funds.[80]

In general, this means that a trustee can avoid wages garnished during the preference period even if the garnishment order was issued before the preference period, while the garnishment of non-wage assets requires a more detailed analysis of the specific facts and relevant state law.

C. AVOIDING PREPETITION SETOFFS

In some circumstances, a debtor may be able to avoid a setoff during the preference period. However, federal agencies often may retain amounts collected through offset during the preference period. Because a prepetition setoff generally is not avoidable as a preferential transfer under 11 U.S.C. § 547.[81]

Section 553(b) of the Bankruptcy Code limits a creditor's setoff rights if the creditor improved its position relative to other creditors within the 90-day period immediately preceding the petition date. To determine whether there has been an improvement in position, courts determine what the creditor's "insufficiency"[82] was at the time of setoff. To the extent that the "insufficiency" decreased between the start of the preference period and the setoff date, the setoff constitutes an impermissible preference, and the trustee can avoid the transaction(s).[83]

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[80] *See id.* § 547(e)(1)(B), (e)(3); *see also Barnhill v. Johnson*, 503 U.S. 393, 400-02 (1992); *Morehead v. State Farm Mut. Auto. Ins. Co. (In re Morehead)*, 249 F.3d 445, 449 (6th Cir. 2001); *Freedom Group v. Lapham-Hickey Steel Corp. (In re Freedom Group)*, 50 F.3d 408, 412 (7th Cir. 1995); *Battery One-Stop v. Atari Corp. (In re Battery One-Stop)*, 36 F.3d 493, 495-99 (6th Cir. 1994).

[81] *See* 11 U.S.C. §§ 547, 553; *see also In re Dillard Ford, Inc.*, 940 F.2d 1507, 1513 (11th Cir. 1991); *Lee v. Schweiker*, 739 F.2d 870, 876-77 (3d Cir. 1984).

[82] The Bankruptcy Code defines insufficiency 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 a claim." 11U.S.C. § 553(b)(2). To determine if there is an insufficiency, a court will compare the amount by which the creditor's claim against the debtor exceeded the debtor's claim against the creditor at the time of setoff, against the amount by which the creditor's claim against the debtor exceeded the debtor's claim against the creditor on the ninetieth day prior to the petition date (or if there was no insufficiency on the ninetieth day before the petition date, then the date during the preference period on which there was an insufficiency).

[83] *See id.* §§ 547, 553.

VII. THE RIGHT OF SETOFF

A. BANKRUPTCY CODE PRESERVES SETOFF RIGHTS

The Bankruptcy Code preserves a creditor's right to setoff. Section 553(a) of the Bankruptcy Code provides:

> Except as otherwise provided in this section and sections 362 and 363 of this title, 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 against a claim of such creditor against the debtor that arose before the commencement of the case . . . .

Id. § 553(a). By preserving the right of setoff, the Bankruptcy Code avoids the "absurdity of making A pay B when B owed A." *Strumpf*, 516 U.S. at 18 (quoting *Studley v. Boylston Nat'l Bank*, 229 U.S. 523, 528 (1913)).

Setoff requires mutuality in that the indebtedness must be between the same parties. 11 U.S.C. § 553(a). This generally requires that both debts (i.e., the debt owed ***by*** the debtor and the debt owed ***to*** the debtor) fall on the same side of the bankruptcy line (i.e., on the same side of the timeline marked by the filing of the petition). *See id.* With some exceptions, both debts must either be prepetition or postpetition. *See id.*; *see also Lee v. Schweiker*, 739 F.2d 870 (3d Cir. 1984).

Creditors with prepetition setoff rights have a secured claim under section 506(a)(1) of the Bankruptcy Code.[84] Therefore, agencies with setoff rights should take appropriate steps to protect their interests.

B. TYPES OF SETOFF (OFFSET)

(1) Offset of Federal Tax Overpayments

Federal agencies are authorized to offset certain federal payments to collect delinquent debt owed to the United States. *See* 31 U.S.C. §§ 3716, 3720A; *see also* 26 U.S.C. § 6402(d). This includes the authority to offset tax overpayments for debts owed to the United States. 26 U.S.C. § 6402(a), (d); 31 U.S.C. § 3720A. This applies only to tax refunds for years before the debtor filed for bankruptcy protection. An agency may not offset a debtor's tax refund for any postpetition year, unless the debtor owes postpetition debts to the United States. Some courts have noted an apparent conflict between section 553 of the Bankruptcy Code, which preserves a creditor's setoff rights, and section 522 of the Bankruptcy Code, which describes property that may be exempted from property of the estate. Generally, cases addressing this apparent conflict have arisen in the context of tax refund offset. Most courts, however, have held that no such conflict exists.

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[84] *Id.* § 506(a)(1) ("[a]n allowed claim of a creditor . . . that is subject to setoff under section 553 of this title, is a secured claim . . . to the extent of the amount subject to setoff").

A tax overpayment is any payment made by a taxpayer that is over and above tax liability.[85] A tax refund, on the other hand, is an amount that the Internal Revenue Service (IRS) must pay the taxpayer after the IRS exercises its statutory right of offset.[86] Therefore, the tax overpayment does not necessarily create a debt due to the taxpayer, since the taxpayer has no right to payment until after the IRS reduces the tax overpayment by outstanding federal tax debt, federal nontax debt, child support debt, state income tax debt, and state unemployment compensation debt. *See id.*

In the bankruptcy context, the United States retains this statutory right to reduce a tax overpayment for these types of debts. *See* 11 U.S.C. § 553. The United States retains this right even when a debtor attempts to exempt tax payments under section 522 of the Bankruptcy Code from property of the estate, because a debtor may only exempt property of the estate. *Id.* § 552(b); *see also id.* § 541. Only the portion of the tax overpayment remaining after IRS deducts the amounts under 26 U.S.C. § 6402 constitutes a tax refund that would become property of the estate. Thus, a debtor's attempt to exempt its tax refund will not affect the United States' right of statutory offset under 26 U.S.C. § 6402. If an agency anticipates that a debtor in bankruptcy will be receiving a tax payment, it should contact the IRS to request that payment be withheld until the creditor agency can request and obtain relief from the automatic stay to conduct the offset.

While most courts have found that there is no conflict between section 522 (exemptions) and section 553 (setoff) of the Bankruptcy Code, some courts have disagreed. These courts, nevertheless, have generally found that any attempt by the debtor to exempt the tax refund would not affect the setoff rights of the United States and that the setoff rights of the United States would prevail over a debtor's attempted exemption.[87]

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[85] *See, e.g.*, *Copley v. United States*, 959 F.3d 118, 122-26 (4th Cir. 2020); *United States v. Gould (In re Gould)*, 401 B.R. 415, 426-27 (B.A.P. 9th Cir. 2009); *IRS v. Luongo (In re Luongo)*, 259 F.3d 323, 335 (5th Cir. 2001); *USDA Rural Hous. Serv. v. Riley (In re Riley)*, 485 B.R. 361, 365 (W.D. Ky. 2012); United States v. White, 365 B.R. 457, 463 (M.D. Pa. 2007); *Beaucage v. United States*, 342 B.R. 408, 411 (D. Mass. 2006); *Newberry v. United States (In re Newberry)*, No. 12-40455, 2013 Bankr. LEXIS 622, at *14-15 (Bankr. S.D. Ill. Feb. 19, 2013); *In re Scales*, 477 B.R. 679, 684 (Bankr. N.D. Ohio 2012); *In re Abbott*, No. 12-01166-8, 2012 Bankr. LEXIS 3009, at *5-6 (Bankr. E.D.N.C. July 3, 2012); *Gordon v. United States (In re Sissine)*, 432 B.R. 870, 881-82, 887 (Bankr. N.D. Ga. 2010); *Jones v. IRS (In re Jones)*, 359 B.R. 837, 840-41 (Bankr. M.D. Ga. 2006); *In re Baucom*, 339 B.R. 504, 506-07 (Bankr. W.D. Mo. 2006); *In re Pigott*, 330 B.R. 797, 802 (Bankr. S.D. Ala. 2005); *In re Shortt*, 277 B.R. 683, 687-88 (Bankr. N.D. Tex. 2002); *Wiegand v. Tahquamenon Area Credit Union (In re Wiegand)*, 199 B.R. 639, 641-642 (W.D. Mich. 1996).

[86] 26 U.S.C. § 6402(a). Section 6402(a) of the Internal Revenue Code governs when a taxpayers' overpayment may be paid to the taxpayer. It provides in relevant part:

> In the case of any overpayment, the Secretary, within the applicable period of limitations, may credit the amount of such overpayment, including any interest allowed thereon, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment and shall, subject to subsections (c), (d), (e), and (f), refund any balance to such person.

Id.

[87] *See Junio v. Astoria Fed. Savs.*, No. CV-98-7527, 2002 U.S. Dist. LEXIS 25735, at *24 (E.D.N.Y. Feb. 25, 2002); *Posey v. U.S. Dep't of the Treasury - IRS*, 156 B.R. 910, 916-17 (W.D.N.Y. 1993); *In re Allen*, 266 B.R. 713, 716 (Bankr. N.D. Iowa 2001); *In re Bourne*, 262 B.R. 745, 754-758 (Bankr. E.D. Tenn. 2001); *In re Kadrmas*, No. 00-31338, 2000 Bankr. LEXIS 1764, at *7-16 (Bankr. W.D. Wis. Sept. 19, 2000); *but see United States v. Jones (In re Jones)*, 230 B.R. 875, 880-81 (M.D. Ala. 1999).

(2) Other Types of Offset

For a creditor to have setoff rights under 11 U.S.C. § 553, both the creditor's obligation to the debtor and the debtor's obligation to the creditor must arise prior to the petition date. While the most common example of when both obligations would arise prepetition in the federal debt collection context is when the debtor has made overpayments of federal taxes in the year before its bankruptcy filing, there are other circumstances in which an obligation of the United States may arise prior to the petition date. For example, certain portions of a debtor's federal salary payment may have accrued prior to the petition date. If that debtor owed the United States a federal debt prior to the petition date, the United States would have setoff rights with regard to the portion of the debtor's federal salary payment that accrued prior to the filing of the bankruptcy petition. The same is true for retirement payments, vendor payments, and tort payments, to the extent the right to all or any portion of those payments accrued prior to the petition date.

Therefore, if a creditor agency becomes aware of any federal payment to which the debtor is entitled, the agency should analyze whether its setoff rights have been preserved by section 553 of the Bankruptcy Code. In addition, if an agency is aware of a payment against which the United States may have setoff rights, it should contact the paying agency to determine whether that payment should be withheld until the creditor agency can request relief from the automatic stay. Unless the creditor agency has independent litigating authority, DOJ generally must file a motion on behalf of the creditor agency seeking relief from the stay, and the setoff should not occur until the court grants the motion.

VIII. DISCHARGE

A. SCOPE OF DISCHARGE

(1) Discharge of Personal Liability

A debtor's goal is usually to receive a discharge at the end of the bankruptcy proceeding. *See* 11 U.S.C. § 524(a). With some important exceptions, bankruptcy generally discharges the personal liability of the debtor with regard to all of the debtor's debts. The extent of a discharge depends on the type of bankruptcy proceeding, but will generally be as follows:

- in a chapter 7 case, generally all debts owed by the debtor on the petition date (and some debts incurred during the pendency of the bankruptcy proceeding) will be discharged, *id.* § 727(b);
- in a chapter 11 case, generally all debts owed at the time of plan confirmation will be discharged, *id.* § 1141(d)(1); and
- in chapter 12 and 13 cases, generally all debts provided for by the plan are discharged, *id.* §§ 1228(c), 1328(c).

A discharge, however, does not discharge the debt itself. *Id.* § 524(e). Rather, it eliminates the personal liability of the debtor with respect to the debt. *Id.*; *Johnson v. Home State Bank*, 501 U.S. 78, 82-83 (1991). As a result, the discharge does not affect the rights of secured creditors with regard to their collateral.[88] Similarly, a discharge does not impact creditors' setoff rights.[89] However, if an agency discovers that it has collateral or setoff rights after the conclusion of a bankruptcy proceeding, the agency should, as a precautionary measure, consider asking the court to grant it relief from the discharge injunction before it exercises those rights.

(2) Non-Dischargeable Debts

Although a debtor's debts generally will be discharged in bankruptcy, there are some important exceptions for individual debtors. For example, generally, only debts listed in the debtor's schedules will be discharged. 11 U.S.C. § 523(a)(3). Creditors should be cautious, however, in relying on this exception, because courts may allow debtors to amend their schedules even after a case is closed. *See id.* § 350(b).

Other non-dischargeable debts include certain debts for a tax or customs duty, domestic support obligations, certain fines and penalties imposed by a governmental unit, and debts resulting from educational benefit or overpayment. *Id.* § 523(a)(1), (5), (7)-(8). They also include debts resulting from willful and malicious injury by the debtor to another person. *Id.* § 523(a)(6). Debts obtained as a result of false pretenses, false representations, or actual fraud, as well as certain consumer debts related to the purchase of luxury items during the preference period, also may not be dischargeable. *Id.* § 523(a)(2), (4). Debtors also cannot discharge criminal fines and restitution payments. *Id.* §§ 523(a)(7), (13), 1328(a)(3). Finally, certain debts to bank regulators for security fraud are non-dischargeable. *Id.* § 523(a)(11), (12), (19).

(3) Discharging Otherwise Non-Dischargeable Debts

Although the debts described above are generally non-dischargeable, a debtor can overcome this default rule in certain circumstances. In chapter 13 cases, for example, several of the debts described in 11 U.S.C. § 523(a) may be discharged. *Id.* § 1328(a)(2). So, in a chapter 13 case, the debtor may be able to discharge more debt that would have been permissible in a chapter 7 case. *See id.* Among other things, student loan debts can be discharged if the debtor demonstrates that exempting the debt from discharge would cause undue hardship to the debtor or the debtor's dependents. *Id.* § 523(a)(8).

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[88] *Dewsnup v. Timm*, 502 U.S. 410, 417 (1992).

[89] *See* 11 U.S.C. § 553; *see also Strumpf*, 516 U.S. at 20; *Luongo*, 259 F.3d at 333; *In re De Laurentiis Entm't Grp., Inc.*, 963 F.2d 1269, 1276-78 (9th Cir. 1992); *In re Davidovich*, 901 F.2d 1533, 1539 (10th Cir. 1990); *Kadrmas*, 2000 Bankr. LEXIS 1764 at *4-7; *In re Conti*, 50 B.R. 142, 149 (Bankr. E.D. Va. 1985).

(4) Effect of Discharge on Co-Debtors

A debtor's discharge on a debt does not discharge the personal liability on that debt of co-debtors who are not in bankruptcy. *See id.* § 524(e). To the extent a co-debtor who is not in bankruptcy is married to a debtor in bankruptcy, however, the discharge may protect community property, thereby providing the spouse with a "phantom discharge."[90] Agencies, therefore, should exercise caution before continuing to pursue collection against a co-debtor spouse of a debtor in bankruptcy.

B. TIMING OF DISCHARGE

The timing of the discharge depends on the type of bankruptcy proceeding. *E.g.*, 11 U.S.C. §§ 727 (stating the general rule that a chapter 7 individual debtor can obtain a discharge after the debtor has sold all non-exempt assets and distributed the proceeds to creditors);[91] 1141(d) (providing that confirmation by the court of a chapter 11 debtor's reorganization plan generally results in a discharge); 1228(a) (noting that a chapter 12 debtor generally receives a discharge after successful completion of all payments in accordance with the court-approved repayment plan); 1328 (specifying that a chapter 13 debtor generally obtains a discharge after the debtor successfully makes all payments required under the court-approved repayment plan).

C. DENIAL OF DISCHARGE

If the court finds that a debtor abused the bankruptcy process, the debtor may be denied a discharge.[92] There are strict deadlines on the filing of an action to deny a discharge or hold a debt non-dischargeable for fraud. The court may also dismiss a bankruptcy case, effectively denying the debtor a discharge, if the debtor is found to have abused the bankruptcy process. *See e.g.*, *id.* §§ 707, 1112, 1208, 1307.

In certain circumstances, the court may revoke a discharge if the debtor obtained the discharge through fraud. *See, e.g.*, *id.* §§ 727(e), 1144, 1228(d), 1328(e). There are also a variety of other circumstances in which a debtor may be denied a discharge.

With some exceptions, a discharge will be denied if the debtor completed a prior bankruptcy proceeding in which it was also the debtor within a certain period before the latest filing. For example, a chapter 7 debtor will not receive a discharge if the debtor received a discharge in a: (i) chapter 11 proceeding less than eight years before the filing date for the chapter 7 proceeding, or (ii) chapter 12 or 13 proceeding less than six years before the filing date for the chapter 7

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[90] *See id.* § 524(a)(3); *see also Rooz v. Kimmel (In re Kimmel)*, 378 B.R. 630, 635-37 (B.A.P. 9th Cir. 2007); *In re Thongta*, No. 07-21837, 2009 Bankr. LEXIS 1428, at *7-8 (Bankr. E.D. Wis. June 5, 2009); *In re Moore*, 318 B.R. 679, 681-82 (Bankr. W.D. Wis. 2004); *First La. Bus. & Indus. Dev. Corp. v. Dyson (In re Dyson)*, 277 B.R. 84, 90 (Bankr. M.D. La. 2002); *Gonzales v. Costanza*, 151 B.R. 588, 589-90 (Bankr. D.N.M. 1993).

[91] Technically, debts owed by entity debtors in chapter 7 proceedings are not discharged because, at the conclusion of the bankruptcy proceeding, such debtors cease to exist.

[92] *See, e.g.*, *id*. § 727 (listing specific reasons why the court can deny a discharge in a chapter 7 case). For example, certain provisions of the Bankruptcy Code require that plans of reorganization be made in good faith. *See id.* §§ 1129(a)(3), 1225(a)(3), 1325(a)(3). Similarly, for certain proceedings, the court must approve the debtor's plan of reorganization, and a discharge is granted only after the court approves the plan. *See id.* §§ 1141, 1228, 1328.

proceeding. *Id.* § 727(a)(8)-(9). Similarly, a chapter 13 debtor will not receive a discharge if the debtor received a discharge: (a) in a chapter 7, 11, or 12 proceeding less than four years before the filing date of the chapter 13 proceeding, or (b) as a result of a prior chapter 13 proceeding within two years before filing for the latest chapter 13 proceeding. *Id*. § 1328(f). Failure to complete a personal financial management course can also result in the denial of a discharge. *E.g.*, *id.* §§ 727(a)(11), 1328(g).

D. DISCHARGE INJUNCTION

The discharge of a debtor "operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor, whether or not discharge of such debt is waived." *Id*. § 524(a)(2). Therefore, it generally bars creditors from taking collection action against the debtor with regard to any discharged debt.

Continued reporting of a discharged debt to credit bureaus may also violate the discharge injunction because it is inaccurate to report a debt for which the debtor is no longer liable.[93] By contrast, it is generally permissible for an agency to accurately report that the debtor was delinquent during the pendency of the bankruptcy case.[94] Offset may also be appropriate to collect against a discharged debt if the mutual debt owed by the agency to the debtor predates the filing of the debtor's petition for bankruptcy. However, because courts can award both injunctive relief and monetary damages for willful violations of the discharge injunction, agencies should consult with their counsel before taking any action to collect debts that may have been discharged in bankruptcy.

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[93] *See generally id.* § 524. *See also Mortimer v. Bank of Am.*, No. C-12-01959, 2013 U.S. Dist. LEXIS 51877, at *27-32 (N.D. Cal. Apr. 10, 2013); *Norman v. Applied Card Sys. (In re Norman)*, Ch. 7 Case No. 04-11682, Adv. No. 01-1133, 2006 Bankr. Lexis 2576, at *4-5 (Bankr. M.D. Ala. 2006).
[94] *See Mortimer*, 2013 U.S. Dist. LEXIS 51877, at *27-32; *Mahoney*, 368 B.R. 579 at 584-86. If the creditor choses to report the discharged debt in this manner, the creditor should also report that the debt was discharged and that the balance on the account is zero to ensure that it is presenting a complete and accurate picture.

E. ENTITIES OUT OF BUSINESS

I. INTRODUCTION

When an entity goes out of business, the entity must pay its creditors before distributing any remaining assets to its owners. Entities created under state law can "dissolve" through state law dissolution proceedings or under title 11 of the United States Code (the Bankruptcy Code). Although applicable law differs from state to state, this section provides a broad overview of how these state-created entities can dissolve through state law dissolution proceedings, wind-down their business, and liquidate. Agencies should be aware of state law when pursuing entities that are out of business.

II. DISSOLUTION

State law generally governs the process for dissolving a state-created entity. Generally, the owners of the entity can choose to dissolve the entity and may do so by filing the appropriate paperwork with the state (e.g., a certificate of dissolution). The principals or owners of the entity generally must notify all creditors and claimants of their intent to dissolve the entity to provide creditors with an opportunity to notify the entity of any unpaid debts. Thereafter, the entity may proceed to wind up its affairs, collect and sell its assets, pay its liabilities, and distribute remaining assets (if any) to the owners of the entity.

III. CONTINUED COLLECTION

If an agency is owed a debt and the debtor-entity has dissolved, the agency should determine whether continued collection is warranted. Agencies should consider the costs of collection, the size of the debt, and whether there are any enforcement principles at issue.

Separate entities are not typically responsible for one another's debts. However, there are several exceptions to this general rule. Agencies should consider whether any of the owners or principals guaranteed the debt and whether the entity is a limited liability entity.

Agencies should also consider whether the principals and/or owners properly dissolved the entity under applicable state law. For example, if the assets of the entity were distributed to any non-federal creditor, the agency should determine whether to pursue the entity's representative for the amount of the distribution. *See* 31 U.S.C. § 3713; *supra* Part II.B. Likewise, agencies should determine whether there are any theories for "piercing the corporate veil" in the event that separate entities behaved as a single entity.[95] In such circumstances, an entity that continues to exist under state law could be liable for the debts of a related, dissolved entity.

[95] In determining whether to pierce the corporate veil, courts consider several factors, including the absence of corporate formalities, commingling of assets, siphoning of corporate funds by a dominant stockholder, and whether the entity is a façade for personal operations of a dominant stockholder.

F. INTEREST, PENALTIES, AND ADMINISTRATIVE COSTS

I. INTRODUCTION

A. REQUIREMENT TO CHARGE INTEREST, PENALTIES, AND ADMINISTRATIVE COSTS

Agencies must charge interest, penalties, and administrative costs[96] on delinquent federal nontax debts. 31 U.S.C. § 3717(a)(1). The requirement to charge these amounts applies to all debts, regardless of whether they have been reduced to judgment.[97] However, there are certain exceptions to this rule. For example, the requirement to assess interest, penalties, and administrative costs under 31 U.S.C. § 3717 does not apply to debts arising out of contracts executed prior to October 25, 1982or if a "statute, regulation required by statute, loan agreement, or contract prohibits charging interest or assessing charges or explicitly fixes the interest or charges."[98]

In such instances, the alternative authority or agreement controls.[99] For example, if a contract, statute, or regulation fixes interest on a federal nontax debt but is silent with respect to administrative costs and penalties, federal agencies may not assess administrative costs or penalties under 31 U.S.C. § 3717 on that debt.[100] Implicit in this exception is the concept that if a regulation or contract sets a different standard for interest, penalties, and administrative costs, then the agency had specific authority to alter section 3717's default rules.[101]

B. TERMINOLOGY

The statute and regulation that set forth creditor agencies' obligation to charge interest, penalties, and costs use a variety of undefined terms. In general, and as used in this *Treatise*, these terms should be given the following meanings:

- "Accrue" (verb) – Refers to the act of accumulating interest and charges on a debt, whether or not the interest and charges are assessed.

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[96] As used in this Part II.F, the terms "administrative costs" and "costs" refer to the "costs of processing and handling delinquent debts" that creditor agencies must charge to debtors in accordance with 31 U.S.C. § 3717(e)(1) and 31CFR § 901.9(c).
[97] *Collins*, 36 F.4th at 496 ("There is no basis to conclude § 3717 ceases to apply to a 'debt' once that debt is reduced to judgment").
[98] 31 U.S.C. § 3717(g)(2); *Precision Pine & Timber, Inc.*, 75 Fed. Cl. at 93 ("even if the contracts were silent regarding interest due, the [Debt Collection Act] would have nonetheless applied"); *United States v. Grynberg Petrol. Co.*, No. 11-cv-02945, 2012 U.S. Dist. LEXIS 171086, at *6-8 (D. Colo. Dec. 3, 2012).
[99] *See Briggs v. United States*, No. C 07-05760, 2009 U.S. Dist. LEXIS 36522, 2009 WL 1176297, at *8 (N.D. Cal. Apr. 30, 2009) (explaining that if charges are not specified in a contract, then 31 U.S.C. § 3717 controls, but if charges are specified in a contract, then the contracted charges apply).
[100] *See* 31 U.S.C. § 3717(g)(1) ("This section does not apply . . . if a statute, regulation required by statute, loan agreement, or contract prohibits charging interest *or* assessing charges or explicitly fixes the interest *or* charges." (emphases added)).
[101] *See id*. § 3717(g)(1) (providing an exception when there is a "regulation *required by statute*" that fixes the interest, penalties, or costs (emphasis added)); *Commonwealth Edison Co. v. U.S. Nuclear Regulatory Comm'n,* 830 F.2d 610, 619 (7th Cir. 1987) (stating that agencies cannot avoid statutory requirements through regulation).

- "Assess" (verb) – Refers to the act of adding certain amounts of interest, penalties, and costs to the principal balance of the debt. For example, costs should be assessed (i.e., added to the principal balance of the debt) as they are incurred, while interest and penalties can be accrued throughout the month, but not assessed (i.e., added to the principal balance of the debt) until the end of the month.
- "Charge" (noun) – May refer to interest, penalties, or costs.
- "Charge" (verb) – Has the same meaning as "assess."
- "Impose" (verb) – Has the same meaning as "assess."

C. DUE PROCESS

Agencies must notify debtors regarding whether and how they will accrue and assess interest, penalties, and costs. 31 CFR § 901.9(a). In general, this notice should be written, and the creditor agency should either mail or hand-deliver it to the debtor at the debtor's most recent address known to the agency. *Id*. This notice is not required if an explanation of these matters was included in a written agreement.[102]

II. INTEREST

A. BACKGROUND

Agencies must charge interest on delinquent nontax debts. 31 U.S.C. § 3717(a)(1); 31 CFR § 901.9(a)-(b).[103] Interest serves as reimbursement for the time value of money.[104] In addition, charging interest serves as "another weapon in the Government's debt collection arsenal" to encourage prompt payment of debts.[105]

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[102] *Id.*; *see also Drake v. U.S. Dep't of Educ.*, 2015 U.S. Dist. LEXIS 18709, at *6-7 (S.D. Miss. Feb. 17, 2015) (holding that the plaintiff's reliance on the notice requirement in 31 CFR § 901.9 was misplaced because the interest, penalties, and administrative costs were established by her student loan promissory note, not 31 U.S.C. § 3717 or 31 CFR § 901.9).

[103] In addition to this statutory requirement, agencies have common law authority to charge interest on delinquent debt. *See Billings v. United States*, 232 U.S. 261, 286 (1914).

[104] *United States v. Gonzales & Gonzales Bonds & Ins. Agency (Gonzales)*, 103 F. Supp. 3d 1121, 1153 (N.D. Cal. 2015) ("The purpose behind interest is to compensate for the loss of use of money."); *Am. Airlines, Inc. v. United States*, 77 Fed. Cl. 672, 684 (2007) ("Interest is imposed, in this and other contexts, to reimburse the Government for the time value of money and loss of use of amounts not paid when they are due."); *see also Motion Picture Ass'n of Am. v. Oman*, 969 F.2d 1154, 1157 (D.C. Cir. 1992); *United States ex rel. Zissler v. Regents of Univ. of Minn.*, No. 3-95-168, 1998 U.S. Dist. LEXIS 10461, at *20 (D. Minn. June 1, 1998).

[105] Debt Collection—Assessment of Interest Pending Waiver Determination, B-212729, 63 Comp. Gen. 10, 12 (1983), *available at* http://www.gao.gov/products/478642; *see also* S. COMM. ON GOV'T AFFAIRS REPORT ON S. 1249, THE DEBT COLLECTION ACT OF 1981, S. REP. NO. 97-378 (1982) (stating that, if agencies fail to charge interest on delinquent debts, "debtors have little or no incentive to make timely payments" and "are likely to pay private sector debts first and their government debts last").

B. INTEREST RATE

(1) Minimum Rate

Agencies must charge a minimum rate of interest equal to the "average investment rate for the Treasury tax and loan accounts for the 12-month period ending on September 30 of each year, rounded to the nearest whole percentage point," which is otherwise known as the Current Value of Funds Rate (CVFR).[106] Agencies may charge a higher interest rate than the CVFR if necessary to protect the rights of the United States,[107] but should do so only in the "most compelling circumstances" to ensure that similar debtors are not treated differently.[108] If an agency does elect to deviate from the minimum rate, it should document the rationale behind its decision. 31 CFR § 901.9(b)(2).

(2) Fixed Rate

The interest rate remains fixed for the duration of the delinquency. 31 U.S.C. § 3717(c)(2); 31 CFR § 901.9(b)(3); *United States v. White-Sun Cleaners Corp.*, No. 09-CV-2484, 2011 U.S. Dist. LEXIS 36470, at *34 (E.D.N.Y. Mar. 9, 2011). However, if a debtor defaults on one repayment plan with an agency and seeks to enter into a new repayment plan, the agency may impose a new rate of interest that "reflects the current value of funds to Treasury" on the execution date of the new agreement, which will then remain fixed for the duration of the new repayment plan. 31 CFR § 901.9(b)(3). When setting a new rate of interest under a new repayment agreement, agencies retain the ability to deviate above the CVFR when necessary to protect the rights of the United States. *See id*. § 901.9(b)(2).

(3) Simple Rate

Generally, agencies may charge only simple, rather than compound, interest. 31 U.S.C. § 3717(f); 31 CFR § 901.9(b)(3) ("Interest shall not be compounded, that is, interest shall not be charged on interest, penalties, or administrative costs . . . ."). However, if a debtor defaults on a repayment plan and enters into a new plan, the creditor agency must add accrued interest, penalties, and administrative costs to the principal balance on which the agency will charge interest pursuant to the new repayment plan. 31 CFR § 901.9(b)(3).

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[106] 31 U.S.C. § 3717(a)(1). The Current Value of Funds Rate is published on the Bureau of the Fiscal Service's website. *See* TREASURY CURRENT VALUE OF FUNDS RATE, https://fiscal.treasury.gov/reports-statements/cvfr/.

[107] 31 CFR § 901.9(b)(2). In *Amax Land Co. v. Quarterman*, 181 F.3d 1356, 1360 (D.C. Cir. 1999), for example, the Minerals Management Service (MMS) found that the CVFR was "inadequate" and, even, a potential cause of underpayments on coal leases because the CVFR was so low that each "lessee had an incentive to withhold payment, invest the amount withheld, and remit payment to MMS at a later date, pocketing the spread between the lessee's investment rate of return and the CVF rate." *See also id.* at 1363 (stating that agencies have authority to impose a higher than compensatory interest rate); *Pa. Dep't of Pub. Welfare v. U.S. Dep't of Health & Human Servs.*, 101 F.3d 939, 943-44 (3d Cir. 1996); *West Virginia v. U.S. Dep't of Health & Human Servs.*, No. 2:97-0245, 2009 U.S. Dist. LEXIS 93829, at *41-42 (S.D. W.Va. Sept. 30, 2009).

[108] 49 Fed. Reg. 8,889, 8,893 (Mar. 9, 1984) (former Federal Claims Collection Standards) ("It is our intent that agencies charge a higher interest rate only under the most compelling circumstances.").

C. ACCRUAL OF INTEREST

(1) Interest Accrued On Principal Balance

Agencies must accrue and assess interest on the principal amount of a delinquent debt, but should not compound interest, meaning that interest should not be charged on interest, penalties, or administrative costs. *See* 31 U.S.C. § 3717(f); 31 CFR § 901.9(b)(3).

As noted in Subsection B(3) above, if a debtor defaults and enters into a new repayment agreement with a creditor agency, the agency must add accrued interest, penalties, and administrative costs to the principal balance under the new repayment agreement, forming a new principal balance on which to charge interest. 31 CFR § 901.9(b)(3).

(2) Date of Accrual

Interest generally begins accruing from the date of delinquency—i.e., the date on which the creditor agency provides the debtor with written notice of the debt and the requirement to charge interest (as well as penalties and administrative costs).[109] However, if a statute, contract, or repayment agreement specifies that interest accrues from an alternate date, then interest will accrue as specified. *Id*. § 901.9(b)(1); *see also id*. § 900.2(b) (defining "delinquent"). If an agency employs an advance billing system to bill debtors and inform them of interest charges, interest may not begin to accrue until the debt is actually owed. *See* 31 U.S.C. § 3717(a)(1) (authorizing accrual of interest on "outstanding" debts). Interest will continue to accrue until "the debt is paid in full or otherwise resolved through compromise, termination, or waiver of the charges." 31 CFR § 901.9(a).

D. ASSESSMENT OF INTEREST

Agencies should establish policies and procedures for how they assess accrued interest. In general, agencies should assess interest every month.

In addition, although interest accrues from the date of delinquency, creditor agencies may not assess interest on an outstanding debt if the debtor pays the amount due within 30 days after the date of delinquency. *See* 31 U.S.C. § 3717(d). The heads of creditor agencies may extend this 30-day grace period on a case-by-case basis so it is critical for each creditor agency to consult its own regulations, in addition to the Federal Claims Collections Standards, when evaluating the circumstances in which it should assess interest on a delinquent debt. *See id*. § 3717(d), (h); 31 CFR § 901.9.

[109] 31 U.S.C. § 3717(b); 31 CFR § 901.9(b)(1); *U.S. Bank, N.A. v. U.S. Dep't of Homeland Sec.*, No. 13-CV-00072, 2014 U.S. Dist. LEXIS 14907, at *8 (E.D. Wis. Jan. 6, 2014); *United States v. St. Augustine College*, No. 88 C 4773, 1991 WL 222099, at *5 (N.D. Ill. Oct. 21, 1991); *Peoples Cartage, Inc. v. Dungan*, No. 89-CV-1754, 1990 U.S. Dist. LEXIS 13597, at *10 (N.D. Ohio Sept. 14, 1990)*; but see Kaiser Found. Health Plan, Inc. v. Sebelius*, No. 08-4890, 2009 U.S. Dist. LEXIS 58660, at *15 n.5, 19-21 (N.D. Cal. July 9, 2009) (finding that, although 31 U.S.C. § 3717 did not allow the agency to charge interest from the date debtor submitted its costs reports, which was earlier than the date the agency sent the debtor notice of the debt, the agency could charge interest from the earlier date under different statutory authority).

III. PENALTIES

A. BACKGROUND

Agencies must assess penalties on delinquent debts. 31 U.S.C. § 3717(e)(2); 31 CFR § 901.9(d). The assessment of penalties, unlike the assessment of interest and administrative costs, is intended to be punitive. *See, e.g.*, *Gonzales*, 103 F. Supp. 3d at 1153 (penalties are intended to "discourage delinquencies and encourage early payment of the delinquent debt in full."); *Am. Airlines, Inc.*, 77 Fed. Cl. at 684 (unlike interest and administrative costs, penalties are "imposed as a punitive measure for late payment"). Penalties also incentivize timely payment. *Id.*

B. PENALTY RATE

Agencies should assess penalties of not more than 6 percent per year.[110] Agencies may assess penalties at lower rates, if they determine it is appropriate to do so.[111]

C. ACCRUAL AND ASSESSMENT OF PENALTIES

(1) Penalty Assessed on Delinquent Balance

Agencies must assess a penalty on any portion of a debt that is outstanding for more than 90 days, including any interest and administrative costs assessed on the principal balance as of such date.[112]

(2) Accrual Date and Assessment of Penalties

Penalties are assessed only on debts that have been delinquent for 90 days or more.[113] For these delinquent debts, however, the date of accrual reverts back to the date of delinquency.[114]

IV. ADMINISTRATIVE COSTS

A. BACKGROUND

In addition to interest and penalties, agencies must charge debtors for the collection costs that the agencies incur as a result of the debtor's delinquency. 31 U.S.C. § 3717(e); 31 CFR § 901.9(c). The purpose of charging costs is to compensate the agency for losses associated with the processing and handling of delinquent debt. *See id.*; *see also Gonzales*, 103 F. Supp. 3d at 1153.

[110] 31 U.S.C. § 3717(e)(2); 31 CFR § 901.9(d).
[111] *Id.*
[112] 31 U.S.C. § 3717(e)(2); 31 CFR § 901.9(d).
[113] *Id.*
[114] *Id.*; *Am. Airlines, Inc.*, 77 Fed. Cl. at 685; *Peoples Cartage, Inc.*, 1990 U.S. Dist. LEXIS 13597, at *10.

B. DETERMINING WHAT CONSTITUTES AN ADMINISTRATIVE COST

Any costs an agency incurs as the result of a debtor's delinquency, including costs of administering a delinquent debt collection program, are administrative costs.[115] Such costs could include, but are not limited to, the following: salaries of employees and other employee costs (such as employee benefits); computer equipment; office space; office supplies; postage; costs of obtaining credit bureau reports or other skip tracking tools and commercial databases; amounts the agency is charged by Treasury for its debt collection services; amounts the agency is charged by a private collection contractor; and overhead costs, including costs of legal and information technology support of its debt collection program.[116]

C. ACTUAL AND ESTIMATED COSTS

Each creditor agency has discretion to choose whether it calculates administrative costs based on actual costs, average, or estimated costs. *See* 31 CFR § 901.9(c) and 285.11(j). Costs may be determined based on overall program costs and need not be based on costs related to the collection of a specific debt.

When calculating administrative costs based on estimated costs, agencies should ensure that charging a debtor for estimated costs is reasonable. *Educ. Credit Mgmt. Corp. v. Barnes*, 318 B.R. 482, 485 (S.D. Ind. 2004) (acknowledging that debtors must overcome a strong presumption in favor of the Government's method of determining administrative costs). One way that an agency may estimate collection costs is through cost averaging, or the multiplication of the total debt by some fraction. Cost averaging can be used as a "tool of efficiency, utilized to capture costs which cannot easily be identified and assigned and tracked individually based on a specific instance." *Id.* (emphasizing that Congress's intent in enacting 31 U.S.C. § 3717(e) was for borrowers, rather than taxpayers, to bear the costs of collecting delinquent educational loans).

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[115] U.S. DEP'T OF THE TREASURY, MANAGING FEDERAL RECEIVABLES: A GUIDE FOR MANAGING LOANS & ADMINISTRATIVE DEBT, 6-17 (2015), *available at* https://www.fiscal.treasury.gov/dms/resources/managing-federal-receivables.html.

[116] *See* 31 CFR 285.12(j); *United States v. Ancient Creations, Inc.*, No. 2:14-cv-1519, 2015 U.S. Dist. LEXIS 175343 at *7-9 (D. Nev. Dec. 14, 2015) (finding a sufficient statutory basis under 31 U.S.C. § 3717(e) for a creditor agency to charge the debtor for the 30% fee charged to the creditor agency by Treasury for its collection efforts), *adopted by* 2016 U.S. Dist. LEXIS 8911 (D. Nev. Jan. 25, 2016); *United States v. Cors*, No. 12 Civ. 2265, 2013 U.S. Dist. LEXIS 180416, at *6-7, 14 (S.D.N.Y. Dec. 23, 2013) (holding that no genuine issue of material fact existed with respect to the debtor's obligation to pay the full amount of the debt, including administrative costs assessed by the creditor agency and fees charged to the creditor agency by Treasury); *United States v. Vilus*, 419 F. Supp. 2d 293, 297-99 (E.D.N.Y. 2005) (discussing the Department of Education's authority to charge for "reasonable collection costs"); *United States v. S. Cal. Edison Co.*, 300 F. Supp. 2d 964, 992 (E.D. Cal. 2004) (finding, in dicta, that 31 U.S.C. § 3717(e) requires the United States to charge debtors for attorneys' fees incurred during the collection process); I TFM § 3-5040.20 (stating that agencies generally must charge the debtor for the costs of processing and handling [delinquent] debts, including any fees the creditor agency is charged by Fiscal Service.").

V. COST OF LIVING ADJUSTMENT

In the case of administrative debts,[117] an agency head may increase the debt by a cost of living adjustment in lieu of interest and penalties (but not in lieu of costs). 31 U.S.C. § 3717(i)(1); 31 CFR § 901.9(e). In applying this approach, the agency must increase a debt by the "percentage by which the Consumer Price Index for the month of June of the calendar year exceeds the Consumer Price Index for the month of June of the calendar year in which the debt was determined or last adjusted." 31 U.S.C. § 3717(i)(2)(A); 31 CFR § 909.1(e). An agency should reserve this alternative approach for instances where there is a legitimate reason to employ it, "such as when calculating interest and penalties on a debt would be extremely difficult because of the age of the debt." 31 CFR § 909.1(e).

VI. SUSPENSION OF COLLECTION ACTIVITY

Generally, an agency may not stop accruing and assessing interest, penalties, and costs on a delinquent debt even if it has suspended debt collection activity.[118] However, if an agency's regulations identify instances in which the accrual and assessment of interest and other charges will be "suspended pending agency review," then the agency may forego charging interest, penalties, and costs on delinquent debts in the circumstances specified by its regulations. 31 CFR § 901.9(a), (h).

VII. WAIVER OF INTEREST, PENALTIES, AND ADMINISTRATIVE COSTS

A. REQUIRED WAIVERS

Although the debt collection laws require the Government to charge interest, penalties, and costs on delinquent debts, certain exceptions exist. For example, if a debtor makes a payment within 30 days after interest begins to accrue, interest and administrative costs shall not be charged on the debt. 31 U.S.C. § 3717(d); 31 CFR § 901.9(g).

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[117] Administrative debts are those debts that do not arise from "extension of Government credit through direct loans, loan guarantees, or insurance" and include debts that arise from "fines, penalties, and overpayments." 31 U.S.C § 3717(i)(2)(B); *see also* 31 CFR§ 901.9(e).

[118] *See* 31 CFR § 901.9(h). Courts do not have the authority to force an agency to forego the imposition interest, penalties, and costs, unless the agency is acting contrary to its regulations promulgated pursuant to 31 CFR § 901.9(h). Nor do courts have the authority to force an agency to waive the collection of these charges. *See id.* § 901.9(g) ("[A]gencies *may* waive interest, penalties, and administrative costs charged under this section . . . ." (emphasis added)); *but see United States v. Gonzales & Gonzales Bonds & Ins. Agency,* No. C-11-4794, 2011 U.S. Dist. LEXIS 145170, at *4-5 (N.D. Cal. Dec. 16, 2011) (without explaining its authority for doing so, the court ordered a stay of the accrual of penalties during the length of the Government-requested stay of the case); *Guirola-Beeche v. U.S. Dep't of Justice*, 662 F. Supp. 1414, 1419 (S.D. Fla. 1987) (noting, erroneously, that a precursor to 31 CFR § 901.9(g) *required* agencies to waive the collection of interest in circumstances where assessment of interest would be against equity and good conscience).

B. DISCRETIONARY WAIVERS

(1) Standards to Evaluate Waiver Requests

Agencies possess further discretionary authority to waive interest, penalties, and administrative costs in circumstances where assessing these charges would be "against equity and good conscience" or "not in the best interest of the United States" or if extending the 30-day repayment window. 31 CFR § 901.9(g); *see also* 31 U.S.C. § 3717(h). An agency can consider whether to waive these charges on its own or at the request of a debtor. When considering whether to grant such a waiver, agencies should give due consideration to the purpose behind charging interest, penalties, and administrative costs. There may be circumstances that justify a waiver of penalties, which are meant to penalize untimely payment, but that do not warrant a waiver of interest and administrative costs, both of which are meant to compensate the Government. *See Gonzales*, 103 F. Supp. 3d at 1152-54 (agreeing with the agency's decision not to waive interest and costs which were compensatory but finding that the agency abused its discretion by not waiving penalties after the debtor offered to pay the principal amount of the debt).

Agencies can waive interest, penalties, and costs only on a case-by-case basis. *See* 31 CFR § 901.9(g). They may not waive these charges on an entire class of debts. Factors to consider in determining whether the accrual and assessment of interest, penalties, and costs would be against equity and good conscience or not in the best interest of the United States include whether:

- charging these amounts would cause undue financial hardship to the debtor;
- in the context of a debt caused by an agency overpayment, the debtor either has relinquished a valuable right or changed positions for the worse and how much time has elapsed between the overpayment and notice to the debtor of the overpayment;
- the debtor made efforts to contact the agency to resolve or pay the debt;
- the debtor received actual notification of the debt and the interest, penalties, and costs that would be charged on the debt; and
- the debtor's disability contributed to the debtor's failure to timely pay the debt.

The mere fact that an agency was at fault for the creation of the debt (i.e., an overpayment by the agency to the debtor) is not sufficient to justify a waiver. Waiver on the basis that certain charges are against equity and good conscience or not in the best interest of the United States generally cannot be justified if there is an indication of fraud, misrepresentation, or lack of good faith on the part of the debtor.

An agency also may justify waiver of interest, penalties, and costs by satisfying the criteria set forth in the FCCS for the compromise of debts. 31 CFR § 901.9(g); s*ee also id.* § 902.2 (providing the bases under which agencies may compromise debts).

(2) Waiver Determination is Not Reviewable

Any decision regarding waiver is within the sole discretion of the agency. The agency's decision, therefore, is not reviewable under the Administrative Procedure Act. *See* 5 U.S.C. §§ 701(a)(2), 702(a)*; but see Gonzales*, 103 F. Supp. 3d at 1152-53 (finding that the court did have authority to review the agency's decision regarding whether to waive the debt for abuse of discretion, because the agency had promulgated standards by which to adjudicate waiver requests).

VIII. APPLICATION OF PAYMENTS

When a debt is paid or collected in partial or installment payments, the creditor agency must apply each partial payment must "be applied first to any contingency fees added to the debt, second to outstanding penalties, third to administrative costs other than contingency fees, fourth to interest, and last to principal." 31 CFR § 901.9(f).