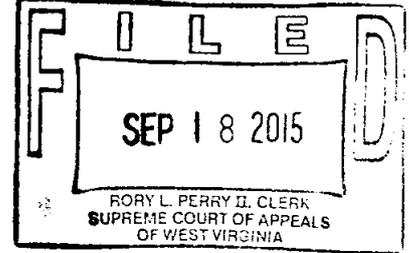


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IN THE WEST VIRGINIA SUPREME COURT OF APPEALS

No. 14-0791 and No. 14-0792



Morgan Drexen, Inc.,
Defendant Below, Petitioner,

v.

Patrick Morrissey, Attorney General,
Plaintiff Below, Respondent,

and

Lawrence Williamson,
Defendant Below, Petitioner,

v.

Patrick Morrissey, Attorney General,
Plaintiff Below, Respondent.

**PATRICK MORRISSEY, ATTORNEY GENERAL'S
BRIEF REGARDING AUTHORITY OF THE COURT TO
PROCEED WITH THE APPEALS**

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INTRODUCTION

This Brief of the West Virginia Attorney General, Patrick Morrissey, is filed pursuant to the Court's Order entered August 25, 2015, lifting the stay imposed by the Court by its May 28, 2015 Order, for the limited purpose of determining whether an exception to the automatic stay under the U.S. Bankruptcy Code, 11 U.S.C. § 362(a), permits the Appeals to proceed.

Morgan Drexen's case was filed under Chapter 7 of the bankruptcy code, in the United States Bankruptcy Court Central District of California, Case No. 8:15-bk-12278-CB, and was converted to one under Chapter 11 on May 14, 2015. After preliminary proceedings, the bankruptcy case was reconverted to Chapter 7 on June 19, 2015.¹

Question Presented

The Court has specifically requested briefing on i) whether the exception to the automatic stay of the Bankruptcy Code, 11 U.S.C. § 362(b)(4), applies to the current appeal of Morgan Drexen, and if so, ii) should the bankruptcy court or this Court decide whether this appeal is excepted from the operation of the automatic stay.

Question Answered

The exception to the automatic stay is applicable to Morgan Drexen's appeal, permitting the Court to move forward with its consideration and disposal of the case, and this Court has concurrent authority to make this determination.

¹ Morgan Drexen's bankruptcy filing did not affect the judgment against Lawrence Williamson. Williamson has not filed for bankruptcy protection, and thus, the Court may proceed with Williamson's appeal regardless of its decision regarding Morgan Drexen's appeal.

ARGUMENT

A. A Government Entity Enforcement Proceeding is Not Stayed by the Bankruptcy Code's Automatic Stay.

As the Court is aware, the filing of a bankruptcy petition creates a stay, known as the “automatic stay,” of certain proceedings or acts against the bankrupt debtor or against the property in the bankruptcy estate. 11 U.S.C. § 362(a). The most relevant portion of this section is found at subsection (a)(1), which prohibits

the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title.

11 U.S.C. § 362(a)(1). Although the automatic stay under federal bankruptcy law generally stays all proceedings and civil actions, there are exceptions to this stay. 11 U.S.C. § 362(b). One of the exceptions permits the Attorney General's enforcement of the civil action commenced against Morgan Drexen and Williamson four years ago to proceed, including their appeals.² Under an exception to the automatic stay in the bankruptcy code, 11 U.S.C. § 362(b)(4), the Attorney General is permitted to commence or continue this civil action to enforce his police or regulatory powers.

The filing of a petition . . . does not operate as a stay –

. . . under subsection (a) of this section, of the commencement or continuation of an action or proceeding by a governmental unit . . . to enforce such governmental unit's or organization's police and regulatory power, including the enforcement of a judgment other than a money judgment, obtained in an action or proceeding by the governmental unit to enforce such government unit's or organization's police or regulatory power;

² The petitions were consolidated by the Court's order entered November 12, 2014.

11 U.S.C. § 362(b)(4). The Attorney General's continuation of this action against Morgan Drexen does not violate the automatic stay. 11 U.S.C. § 362(b)(4). *Bd. of Governors of Fed. Reserve Sys. v. MCorp Fin., Inc.*, 502 U.S. 32, 112 S. Ct. 459, 116 L. Ed. 2d 358 (1991).

Courts have repeatedly held the government exception to the automatic stay, 11 U.S.C. § 362(b)(4), allows a government entity to pursue police or regulatory matters, including the enforcement of consumer protection laws, by investigating a case, filing a complaint, litigating the issues to judgment, pursuing any necessary appeals of such judgment and entry of an enforceable judgment. *Bd. of Governors of Fed. Reserve Sys. v. MCorp Fin., Inc.*, 502 U.S. 32, 112 S. Ct. 459, 116 L. Ed. 2d 358 (1991); *U.S. Dep't of Hous. & Urban Dev. v. Cost Control Mktg. & Sales Mgmt. of Virginia, Inc.*, 64 F.3d 920 (4th Cir. 1995); *In re Commonwealth Companies, Inc.*, 913 F.2d 518 (8th Cir. 1990); *In re Torwico Electronics, Inc.*, 8 F.3d 146 (3d Cir. 1993); *Penn Terra Ltd. v. Dep't of Envtl. Res., Com. of Pa.*, 733 F.2d 267 (3d Cir. 1984); *In re Wade*, 948 F.2d 1122 (9th Cir. 1991); *United States v. Nicolet, Inc.*, 857 F.2d 202 (3d Cir. 1988); *Brock v. Rusco Industries, Inc.*, 842 F.2d 270 (11th Cir.), *cert. denied*, 488 U.S. 889 (1988); *N.L.R.B. v. Edward Cooper Painting, Inc.*, 804 F.2d 934 (6th Cir. 1986); *N.L.R.B. v. Evans Plumbing Co.*, 639 F.2d 291 (5th Cir. 1981); *Sec. & Exch. Comm'n v. First Fin. Grp. of Texas*, 645 F.2d 429 (5th Cir. 1981); *In re First Alliance Mortgage Co.*, 263 B.R. 99 (B.A.P. 9th Cir. 2001); *In re Guardia*, 522 B.R. 734 (Bankr. S.D. Fla. 2014); *In re Family Vending, Inc.*, 171 B.R. 907 (Bankr. N.D. Ga. 1994); *In re Synergy Dev. Corp.*, 140 B.R. 958 (Bankr. S.D.N.Y. 1992). In fact, one of the specific reasons in the legislative history for the government exception is to permit consumer protection matters to proceed to conclusions. A governmental enforcement action “to prevent or stop violation of fraud, environmental protection, consumer protection, safety, or similar police or regulatory laws, or attempting to fix damages for violation

of such a law, the action or proceeding is not stayed under the automatic stay. H.R.Rep. No. 595, 95th Cong., 1st Sess. 343 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6299; S.Rep. No. 989, 95th Cong., 2d Sess. 52 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5838.” *In re First Alliance Mortgage Co.*, 263 B.R. 99 (B.A.P. 9th Cir. 2001). *See also, N.L.R.B. v. Evans Plumbing*, 639 F.2d at 293 (NLRB proceeding may continue to permit entry of judgment for injunctive relief and back pay).

In *U.S. Dept. of Housing & Urban Development v. Cost Control*, the Secretary of Housing and Urban Development ("HUD") brought an action against Cost Control Marketing & Sales Management of Virginia, Inc. ("Cost Control") for violating the Interstate Land Sales Disclosure Act, 15 U.S.C. §§ 1701-1720 ("Land Sales Act"). HUD sought injunctive relief against Cost Control to prevent further violations of the Land Sales Act and also brought an action against its owners and officers, for recovery of all profits gained from violations of the Land Sales Act. The Land Sales Act essentially provides for real estate developers to register with HUD, to provide specified disclosures to prospective customers and requires developers to adhere to certain sales practices, including offering rights to rescind purchases and to not use high-pressure and misleading marketing techniques. *U.S. Dep't of Hous. & Urban Dev. v. Cost Control Mktg. & Sales Mgmt. of Virginia, Inc.*, 64 F.3d at 923-924.

Prior to entry of an \$8.65 million judgment against the officers in *U.S. Dept. of Housing & Urban Development*, the officers had filed Chapter 7 bankruptcy petitions and had received discharges. *Id.* at 925. The officers then argued that the judgment was unenforceable since they had been discharged in bankruptcy. The Fourth Circuit Court of Appeals rejected this argument. HUD was not stayed from proceeding in its civil action to obtain judgment against the debtor-officers. The Circuit Court held:

In short, though the filing of a bankruptcy petition ordinarily acts as a stay of pending judicial proceedings, 11 U.S.C. § 362(a)(1), the stay does not apply to "the commencement or continuation of an action or a proceeding by a governmental unit to enforce such governmental unit's police or regulatory power[.]" § 362(b)(4).

Id. at 927. Therefore, the judgment entered against the Chapter 7 debtors during the pendency of their bankruptcy cases was non-dischargeable and enforceable against them in spite of the bankruptcy filing. The debtor-officers also argued that HUD's action was not excepted from the automatic stay since it was trying to obtain a money judgment and some of the money would be paid to injured consumers. *Id.* at 927.¹ The Fourth Circuit also rejected this argument, holding that "so long as the government's interest in enforcing a debt is penal, it makes no difference that injured persons may thereby receive compensation for pecuniary loss." *Id.* at 928.

In *In re Commonwealth Companies, Inc.*, the debtors argued that the government enforcement exception to the automatic stay was inapplicable to their cases since there was no imminent or ongoing harm to prevent or stop. The *Commonwealth Companies'* court relied on *Matter of Commonwealth Oil Ref. Co., Inc.*, 805 F.2d 1175, 1184-86 (5th Cir. 1986), to reject

1

Moreover, because discharge in bankruptcy is not intended to be a haven for wrongdoers, a Chapter 7 debtor may not discharge "a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and [that] is not compensation for actual pecuniary loss." 11 U.S.C. § 523(a)(7).

* * *

The Supreme Court has given § 523(a)(7) a broad reading, and has held that it applies to all criminal and civil penalties, even those designed to provide restitution to injured private citizens."

U.S. Dept. of Housing & Urban Development, 64 F.3d at 927-928(citing *Kelly v. Robinson*, 479 U.S. 36, 107 S. Ct. 353, 93 L. Ed. 2d 216 (1986)); *Pennsylvania Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 562, 110 S. Ct. 2126, 2132-2133, 109 L. Ed. 2d 588 (1990).

that argument.² The Court further found that the legislative history to the exceptions for the automatic stay permit "the government to seek the entry of a money judgment as its sole remedy for the violation of a fraud or other police or regulatory law." *In re Commonwealth Companies, Inc.*, 913 F.2d 518, 522 (8th Cir. 1990).³ See also *E.E.O.C. v. McLean Trucking Co.*, 834 F.2d 398, 400-02 (4th Cir. 1987)(EEOC is not required to seek relief from the automatic stay in Bankruptcy Court before commencing or continuing an action to enforce its police or regulatory powers even though only monetary relief was available to the EEOC since the debtor had stopped operations).

² "We agree with the Fifth Circuit that the language of § 362(b)(4) 'is unambiguous-- it does not limit the exercise of police or regulatory powers to instances where there can be shown imminent and identifiable harm or urgent public necessity.'" *In re Commonwealth Companies, Inc.*, 913 F.2d 518, 522 (8th Cir. 1990), quoting *Matter of Commonwealth Oil Ref. Co., Inc.*, 805 F.2d 1175, 1184 (5th Cir. 1986).

³Legislative history further supports the State's position.

Paragraph (4) Excepts commencement or continuation of actions and proceedings by governmental units to enforce police or regulatory powers. Thus, where a governmental unit is suing a debtor to prevent or stop violation of fraud, environmental protection, consumer protection, safety, or similar police or regulatory laws or attempting to fix damages for violation of such a law, the action or proceeding is not stayed under the automatic stay.

Paragraph (5) Makes clear that the exception extends to permit an injunction and enforcement of an injunction and to permit the entry of a money judgment, but does not extend to permit enforcement of a money judgment.

S. Rep. No. 989, 95th Cong., 2d Sess. 52, reprinted in 1978 U.S. Code Cong. & Admin. News 5787, 5838; H.R. Rep. No. 595, 95th Cong., 2d Sess. 343 (1977), reprinted in 1978 U.S. Code Cong. & Admin. News 5963, 6299.

In re Commonwealth Companies, Inc., 913 F.2d 518, 522 (8th Cir. 1990).

Therefore, the State's action, now on appeal to this Court, is not stayed by operation of the Bankruptcy Code. This Court may proceed to determine the merits of the appeals filed by Morgan Drexen and Lawrence Williamson. This action is excepted from the automatic stay imposed under the Bankruptcy Code. 11 U.S.C. § 362(b)(4).

B. Non-bankruptcy Courts Have Concurrent Authority to Determine Applicability of the Automatic Stay and Exceptions Thereto.

This Court has the authority, concurrent with the bankruptcy court, to determine whether the police power exception to the automatic stay applies. The leading case on this issue held “Whether the stay applies to litigation otherwise within the jurisdiction of a district court or court of appeals is an issue of law within the competence of both the court within which the litigation is pending” and the bankruptcy court supervising the reorganization. *In re Baldwin-United Corp. Litig.*, 765 F.2d 343, 347 (2d Cir. 1985)(citations omitted). The source of this authority comes from the bankruptcy jurisdictional provisions of the U.S. Code. The code provides, “notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have *original but not exclusive jurisdiction* of all civil proceedings arising under title 11, or arising in or related to cases under title 11.” 28 U.S.C. § 1334(b)(emphasis added).

Since non-bankruptcy courts have concurrent jurisdiction to determine if the bankruptcy automatic stay applies, a governmental entity such as the Attorney General need not seek relief from the bankruptcy court before proceeding with an appeal. *N.L.R.B. v. Edward Cooper Painting*, 804 F.2d at 939(no reason for government entity to seek relief from the stay when its enforcement proceeding is automatically excepted from the stay under 11 U.S.C. § 362(b)(4)); *In re Baldwin-United Corp. Litig.*, 765 F.2d 343, 347 (2d Cir. 1985)(“The court in which the litigation claimed to be stayed is pending has jurisdiction to determine . . . whether the proceeding

pending before it is subject to the automatic stay.”); *U.S. Dept. of Housing & Urban Development v. Cost Control*, 64 F.3d at 927(district court had concurrent jurisdiction with bankruptcy court to determine automatic stay issue); *In re Gandy*, 327 B.R. 796, 800-801 (Bankr. S.D. Tex. 2005)(state courts have authority to determine whether the automatic stay applies); *In re Bona*, 124 B.R. 11, 15 (S.D.N.Y. 1991)(New Jersey state court had concurrent jurisdiction with bankruptcy court to determine the applicability of the automatic stay). *See also*, *E.E.O.C. v. McLean Trucking*, 834 F.2d at 400-02(Equal Employment Opportunity Commission is not required to seek relief from the automatic stay in Bankruptcy Court before commencing or continuing an action to enforce its police or regulatory powers); *N.L.R.B. v. Edward Cooper Painting*, 804 F.2d 934(NLRB, a governmental unit, not required to seek relief from bankruptcy court prior to continuing to enforce its police and regulatory powers); *Sec. & Exch. Comm'n v. First Fin. Grp. of Texas*, 645 F.2d 429 (5th Cir. 1981)(appointment of receiver in a continuing SEC proceeding was exempted from the automatic stay); *In re 1736 18th St., N.W., Ltd. P'ship*, 97 B.R. 121, 123 (Bankr. D.D.C. 1989)(rent administrator has jurisdiction to decide if the automatic stay is applicable); *Westlund v. State, Dep't of Licensing*, 55 Wash. App. 82, 778 P.2d 40, 41 (1989)(state courts may determine if the automatic stay is applicable or an exception applies). Furthermore, the filing of a bankruptcy petition and the imposition of the automatic stay “does not divest all other courts of jurisdiction to hear every claim that is in any way related to the bankruptcy proceeding.” *Picco v. Global Marine Drilling Co.*, 900 F.2d 846, 850 (5th Cir. 1990); *In re Edwin A. Epstein, Jr. Operating Co., Inc.*, 314 B.R. 591, 598-99 (Bankr. S.D. Tex. 2004).

Police and Regulatory Powers – two prong test

a. Governmental Unit

To determine whether an action falls under the police and regulatory power exception, a court must engage in a two-pronged test. *In re Gandy*, 327 B.R. at 802. The court must first determine whether the plaintiff in the state court action is a “governmental unit” as defined by the Bankruptcy Code. Then the court must next determine whether the governmental unit’s action is an exercise of its police and regulatory power. *Id.* at 803.

The Bankruptcy Code defines "governmental unit" to include government at the federal, state and local levels and includes a government "department, agency or instrumentality" of the State, as a state. 11 U.S.C. § 101(27). The Attorney General, a constitutional officer of the State of West Virginia is clearly a "governmental unit" as defined by the Bankruptcy Code. There is no question that the Attorney General is enforcing his police and regulatory powers as granted by the West Virginia Legislature when he brings a civil action under the West Virginia Consumer Credit and Protection Act. W. Va. Code § 46A-1-101 *et seq.* The action against Morgan Drexen was brought under the West Virginia Consumer Credit and Protection Act.

A governmental unit may also obtain a judgment in its enforcement suit fixing civil penalties for purposes of the bankruptcy. *S.E.C. v. Bilzerian*, 131 F. Supp. 2d 10, 14 (D.D.C. 2001) *aff'd*, 75 F. App'x 3 (D.C. Cir. 2003). “A state court may liquidate the claim and enter a judgment but the governmental unit is stayed from enforcing the money judgment against a debtor without an order from the bankruptcy court.” *In re Gandy*, 327 B.R. at 803. *See also*, *N.L.R.B. v. Evans Plumbing Co.*, 639 F.2d at 293(NLRB proceeding may continue to permit entry of judgment for injunctive relief and back pay).

b. Police and Regulatory Powers

i. Pecuniary Interest Test

In determining whether the State is enforcing its police and regulatory powers, courts look to see if the civil action is to advance its own pecuniary interest or to pursue a matter of public policy. *In re Gandy*, 327 B.R. at 802-803. Under the pecuniary interest test, the court must determine if the state is merely advancing its pecuniary interests. *Id.* at 803. *In re Commonwealth Companies, Inc.*, 913 F.2d at 523. Collecting damages, from a contract breach, that do not arise from a police or regulatory violation would be an example of the state advancing its pecuniary interests. *In re Gandy*, 327 B.R. at 803. Tax collection efforts would be another. *Id.* The State's action against Morgan Drexen is a matter of public policy – enforcement of consumer protection laws. Morgan Drexen did not breach a contract with the state. Rather, it engaged in multiple violations of the Consumer Credit and Protection Act for which civil penalties were imposed. The State sought to enjoin Morgan Drexen from continued violation of the Consumer Credit and Protection Act as well as seeking civil penalties and other equitable relief. The circuit court's final order permanently enjoins Morgan Drexen from violating the Consumer Credit and Protection Act, imposes civil penalties and orders restitution. Enforcement of consumer protection laws and the fixing of damages for violations thereof were two reasons given in the legislative history for excepting governmental units from operation of the automatic bankruptcy stay, to enforce their regulatory and police powers. H.R.Rep. No. 595, 95th Cong., 1st Sess. 343 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6299; S.Rep. No. 989, 95th Cong., 2d Sess. 52 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5838. Thus, the State's action passes the pecuniary interest test.

ii. Public Policy Test

The alternative public policy test asks courts to determine whether the proceeding is designed to effectuate public policy rather than adjudicate private rights. *N.L.R.B. v. Edward Cooper Painting*, 804 F.2d at 942; *In re Dunbar*, 235 B.R. 465, 471 (B.A.P. 9th Cir. 1999) *aff'd*, 245 F.3d 1058 (9th Cir. 2001); *In re Gandy*, 327 B.R. at 803-804. Courts can look to the legislative history to see if one of the enumerated examples describes the action of the state. In this case, the State is enforcing the Consumer Credit and Protection Act and seeking to fix penalties, restitution and attorneys' fees arising from the violations of the Act. *See Matter of Commonwealth Oil Ref. Co., Inc.*, 805 F.2d at 1182-83 (quoting the legislative history). Consumer protection enforcement is one of the examples of excepted activities in the legislative history. *See* S. Rep. No. 989, 95th Cong., 2d Sess. 52, reprinted in 1978 U.S. Code Cong. & Admin. News 5787, 5838; H.R. Rep. No. 595, 95th Cong., 2d Sess. 343 (1977), reprinted in 1978 U.S. Code Cong. & Admin. News 5963, 6299. The State clearly was enforcing public policy. The State primarily seeks injunctive relief when enforcing the Consumer Credit and Protection Act. W. Va. Code § 46A-7-108. Civil penalties are permitted for willful and repeated violations of the Act, W. Va. Code § 46A-7-111(2), thus furthering the State's interest in deterring and penalizing violations of the Act. *In re First Alliance Mortgage Co.*, 263F.3d at 108 (consumer protection actions seeking penalties fall "squarely within [the state's] public policy of protecting consumers and deterring violators.").

Although the Morgan Drexen trial court also ordered restitution to be paid to consumers, the equitable remedy was not quantified. Even if it had been, most courts have held the fixing of damages for consumer protection violations promote the public policy of protecting consumers from unfair or deceptive business practices. *In re First Alliance Mortgage Co.*, 263F.3d at 109,

n. 9 (noting that awards of restitution may be essential for the state to protect its regulatory interests even though private parties may benefit), *citing In re Berg*, 230 F.3d 1165, 1168 (9th Cir. 2000) (public policy promoted by affirming attorneys' fees award as a sanction and not stayed by the automatic stay). Even if private rights are benefitted by the State's action, the imposition of the award enhances the state's enforcement efforts of the Consumer Credit and Protection Act, and are secondary to the state's primary police and regulatory function. *U.S. Dep't of Hous. & Urban Dev. v. Cost Control*, 64 F.3d at 928("so long as the government's interest in enforcing a debt is penal, it makes no difference that injured persons may thereby receive compensation for pecuniary loss"). *See also N.L.R.B. v. Evans Plumbing Co.*, 639 F.2d at 293(judgment for back pay in NLRB unfair labor proceeding does not violate the automatic stay); *Penn Terra Ltd.*, 733 F.2d at 278-79(expenditure of large sums of money by debtor to comply with injunction excepted from automatic stay). Thus, the State's action also passes the public policy test.

CONCLUSION

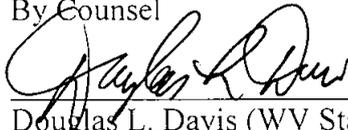
The State has not sought to proceed with collection efforts. It is merely attempting to fix the amounts awarded to it by the trial court, and affirmatively represents that its judgment claims have been presented to the bankruptcy court in order to collect on the judgments in the orderly course of administration of the bankruptcy case.

WHEREFORE, the State respectfully requests this Court continue its consideration of these matters, and enter a decision on Morgan Drexen's and Williamson's petitions when appropriate as if the bankruptcy filing by Morgan Drexen had not occurred.

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